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P R O C E D I N G S

CHAIRMAN ANGELIDES: Good morning. The meeting of the Financial Crisis Inquiry Commission will come to order. As everyone who joined us yesterday knows, we are in the midst of three days of hearings on the issues of subprime lending and securitization and how the subprime origination phenomenon and securitization phenomenon may have impacted our financial and economic crisis with which we are dealing in this country today.

Yesterday we heard from Alan Greenspan, from the Federal Reserve, and from officials from Citigroup.

Today we are hearing, again, from officials from Citigroup, both Mr. Rubin and Mr. Prince, and later today from officials from the Office of the Comptroller of the Currency. And tomorrow we will continue our hearings in this same cool, not really air-conditioned room, on Fannie Mae and OFHEO.

So, with that, I would like to begin our hearing. We have two witnesses today, Mr. Chuck Prince, the former chairman and CEO of Citigroup, and Mr. Robert Rubin, the former treasury-secretary of the United States of America as well as the chairman of the executive -- former chairman of the executive committee of the board of directors of Citigroup. Thank you, gentlemen, for being with us here this morning.

What I would like to do, to start off, as we are doing with all witnesses who appear before us in the course of our hearings, both before you and after you, is we are customarily swearing every witness in. So, with that, I would like to ask each of you, both of you, to please stand up so that I can swear you in front of the Commission. Thank you.

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

MR. PRINCE: Yes, sir.

MR. RUBIN: Yes.

CHAIRMAN ANGELIDES: Thank you, very much.

Gentlemen, you have provided us with written testimony, which we have in hand. And I'm going to ask each of you, this morning, to provide us with oral testimony of -- not to exceed ten minutes.

And so, with really no further ado, Mr. Prince, I will ask you to start this morning. Please turn on the microphones and pull them as closely to you as you can and let's commence.

Mr. Prince?

MR. PRINCE: Thank you. Chairman Angelides, Vice Chairman Thomas, members of the Commission, let me start by saying I'm sorry. I'm sorry that the financial crisis has had such a devastating impact on our country. I'm sorry for the millions of people, average Americans, who have lost their homes. And I'm sorry that our management team, starting with me, like so many others could not see the unprecedented market collapse that lay before us.

I was the CEO of Citigroup from October 2003 until November 4, 2007. Before becoming CEO, I held various positions in Citi's senior management. For nearly 30 years until November 4, 2007, when I resigned, Citi and its predecessors was my professional life.

I have given a great deal of thought to the unique events that led to the financial crisis and which brings us here today. I wanted to share some of my views, which I believe are important to set the context for the problems that arose at Citi as well as many other financial institutions and eventually led to Citi's receipt of government assistance.

The financial crisis resulted from a confluence of several factors, the absence of any of which would likely have caused the crisis to be averted or significantly moderated.

First was the unusually long period of low interest rates, stemming from a change in the pattern of global funds flows following the 1998 emerging markets financial crisis, as well as the stimulative actions of the Federal Reserve Board, following the bursting of the tech bubble and the terrorist attacks of 9/11.

As a result, investors were reaching for yield, and many people from investors to traders to rating agencies to regulators believed that a new era of generally lower risk had begun.

During this period, securitized products, as an asset class, grew dramatically in an effort to satisfy investor demand for products that had higher yields but were still believed to have a high degree of safety.

The growth in securitized products also reflected a growing belief in and reliance on financial modeling by traders as a basis for risk decisions and a growing reliance on rating agency determinations by investors.

As a result of the rapid growth and demand for assets to be securitized, together with longstanding and bipartisan federal policies encouraging the expansion of home ownership, the asset class of subprime mortgages grew very quickly.

The patchwork nature of state regulation of the origination of subprime, indeed of all mortgages, led in hindsight to the origination of more and poorer-quality subprime assets to be securitized.

Eventually the rating agencies dramatically downgraded their ratings on the securitized products collateralized by these subprime loans.

The precipitous nature of the actions by the rating agencies, together with the widespread holdings of these securities, caused a broad and generalized freezing of the securities markets as investors could no longer be sure what standards and models of risk and safety could be relied upon and who held what levels of risk.

This general freezing of the credit markets then precipitated a severe contraction of trade that led to the general recession that still afflicts us.

It is against this backdrop that the events at Citi and of many other banks and financial institutions took place. Specifically, on November 4, 2007, Citi announced an estimated 8 billion to 11 billion dollars in write-downs related to subprime-related holdings. That same day, I resigned as CEO.

After I left, Citi incurred even greater losses, which eventually lead Citi to receive over 45 billion dollars in Federal TARP funds. As the Commissioners are no doubt already aware, the largest losses at Citi emanated from what were perceived at the time to be extremely safe, super senior tranches of CDOs that carried the lowest possible risk of default.

It bears emphasis that Citi was by no means alone in this view and that everyone, including our risk managers, government regulators, other banks and CDO structurers, all believed that these securities held virtually no risk, a perception strongly reinforced by the above Triple-A-rating bestowed by the rating agencies.

Citi's write-downs on these specific securities totaled some 30 billion dollars over a period of six quarters. And I believe it is fair to say that this factor alone made a substantial part of the difference between Citi's ultimate problems and those of other banks.

While I was not aware of the decisions being made on the trading desks to retain these super senior tranches, given the universal perception that these super senior positions were extremely low risk, it is hard for me to fault the traders who made the decisions to retain these positions on Citi's books, having 40 billion dollars of Triple-A-plus-rated paper on the balance sheet of a 2-trillion-dollar company would not raise a concern.

Moreover, it is important to appreciate that the CDO business, which was a small part of a large and complex financial organization, was being managed by highly experienced traders and risk managers and was fully transparent to our regulators who were embedded across the company.

In retrospect it turned out that that risk assessment, while widely held, was dramatically wrong given the wholly unanticipated and significant collapse in residential real estate values across the board in nearly every community and geographic location nationwide and across many parts of the world.

In that context, let me say something about risk. I always believed that the risk function at Citi was a critical part of our overall business. After becoming CEO, one of the very first things I did was to name David Bushnell as the chief risk officer of the company and to change the reporting structure so that the risk function was then completely independent of the businesses which it was not before.

The risk professionals were not paid on profits, were not paid on volumes or revenues of the business units, and I believe that that was good governance, and I believe that we were ahead of best practices at that time.

Mr. Bushnell was known as one of the most sophisticated risk managers in the investment banking community, with a strong hands-on trading background.

As serious issues unfolded in the late summer and fall of 2007 relating to the subprime market and our lower-rated CDO holdings as well as certain other businesses, such as leveraged lending, our senior management was fully focused on the unprecedented issues the company faced. We had multiple special board and committee meetings to apprise the board members of the issues as they developed in real time and to solicit their valuable advice and counsel.

Regrettably, we were not able to prevent the losses that occurred, but it was not a result of management or board inattention or a lack of proper reporting of information.

The lessons learned from this experience are many, but let me address two issues that seem to come up repeatedly when discussing Citigroup. Is Citi too big to fail? And is it too big to manage?

These are separate but related questions as you know. Let me start with the latter.

I personally do not think Citi was too big to manage, to be sure, it was a challenge, but we made enormous strides during my tenure to improve the way in which the various parts of Citi work together. And I think the company as a whole was much better for it.

In any event, I do not think that the broad, multifaceted and diversified nature of Citi's businesses materially contributed to our losses or to the financial crisis more generally. Indeed, smaller, more narrowly focused firms suffered in similar ways.

To the contrary, I continue to believe that Citi is a unique institution. It is the only truly international U.S.-based bank, a feature that gives it great advantages in many of its businesses and around the globe.

Now, too big to fail is a harder issue. My own view is that we are past the days of exclusively small local-based banks and financial institutions. While these local institutions certainly have a place in the financial landscape, the financial world we live in is complex, interconnected, and global. And I think this demands sophisticated, global, and diversified financial institutions. That said, I certainly do not believe it is good for the United States to have a financial system with a failure or threatened failure of key financial institutions will impose the kind of dramatic and near catastrophic damage on the entire financial system and the national world economy that we saw when Lehman failed and when numerous other financial institutions, including Citi, needed extraordinary government assistance.

We must find a solution to this problem, whether through resolution authority, greater regulation, increased capital requirements, or all of the other creative and innovative measures that your Commission has been discussing.

Thank you for your time and I'm happy to answer your questions.

CHAIRMAN ANGELIDES: Thank you very much, Mr. Prince. Mr. Rubin?

MR. RUBIN: Thank you, Mr. Chairman. Mr. Chairman, Mr. Vice Chairman, distinguished members of the Commission, I, too, along with Chuck Prince appreciate the opportunity to testify today.

The financial crisis, as we all know, has taken a terrible toll on millions of Americans who have lost their homes, their jobs, their savings, and their confidence in the future of our economy. Better understanding the cause of the crisis is essential to protecting our nation's economic future and to effective financial reform.

I hope that my experience at Goldman Sachs, the National Economic Council, the Treasury Department, Citigroup, and this chair of LISC, our nation’s largest inner-city development organization can be helpful to this inquiry.

Let me make two observations that I believe are relevant to the Commission's work. First, examining problems with the benefit of hindsight can be highly useful. During my time at Treasury, we dealt with the Mexican financial crisis and then later the Asian financial crisis.

And while, in both cases, our approaches on balance were successful, we still learned an enormous amount from looking back at what happened.

Second, as policymakers address financial reform, it is important to remember that our national economic policies have enormous effect on all of us. For example, President Clinton undertook deficit reduction and made critical public investments, and those policies, in my view, contributed greatly to the longest economic expansion in American history. Simply put, policy matters.

With those thoughts in mind, let me turn to the causes of the financial crisis. While I had thought for some time, prior to the crisis, that markets including the market for credit had gone to excess and that those excesses would at some unpredictable point lead to a cyclical downturn, this is not what happened.

Instead, we experienced the most severe financial and economic crisis in 80 years. In my view, that crisis was not the product of a single cause but rather the product of an extraordinary combination of powerful factors operating at the same time and feeding on each other.

Let me name just a few of those factors: Market excesses; low interest rates most notably due to large capital inflows from abroad, which contributed to excessive risk taking by lenders and excessive borrowing by businesses and consumers; a sharp rise in housing prices, which also contributed to increased consumer leverage; a subsequent precipitous drop in housing prices; vast increases in the use and complexity of derivatives; misguided Triple-A ratings of subprime mortgage-based instruments; lax and too often abusive mortgage lending practices; shortfalls in regulation; high levels of leverage in financial institutions joined with deteriorating asset quality in asset purchases and much else.

There were a few market participants or analysts who saw the broad picture and the potential for a mega-crisis. A larger number saw one or a few of these factors. But almost all of us, including me, who were involved in the financial system, that is to say, financial firms, regulators, rating agencies, analysts, and commentators missed the powerful combination of factors that led to this crisis and the serious possibility of a massive crisis. We all bear responsibility for not recognizing this, and I deeply regret that.

Let me now turn to Citigroup more specifically. My role in Citi, defined at the outset, was to engage with clients across the bank's businesses here and abroad, to meet with foreign public officials for bank presence in 102 countries, and to serve as a resource to the bank's senior management with respect to strategic and managerial matters.

Having spent my career in positions with significant operational responsibility, at Treasury and, prior to that at Goldman Sachs, I no longer wanted such a role at this stage in my life. And my agreement with Citi provided that I'd have no management of personnel or operations.

I remained with Citi until January of 2009, and so wasn't present when Citi's problems occurred. In my view, there were two primary causes of these problems. First, Citi, like other financial institutions, suffered large losses due to the financial crisis.

I am told that Citi has subsequently analyzed the data made available in connection with the 2009 stress tests and has estimated that the losses of Citi's businesses other than CDOs were roughly comparable to peer firms.

Second, Citi suffered distinctively high losses as a result of its retention of so-called super senior tranches of CDOs.

I first recall learning of these super senior positions in the fall of 2007 during discussions convened by Chuck Prince with the most senior management of Citi to discuss what by then was considerable turmoil in the fixed-income markets.

In a presentation on the fixed-income business, I learned that Citi's exposure included 43 billion dollars of super senior CDO tranches.

The business and risk personnel involved advised these CDO tranches, related to Triple-A-plus, and had de minimus risk. My view, which I expressed at the time, was that the CDO business was an arbitrage activity and that I believed, perhaps because of my arbitrage background, that these CDO transactions were not completed until the distribution was fully executed.

Having said that, it is important to remember that the view of the securities to be retained was developed at a time when Triple-A securities had always been considered "money good."

Moreover, these losses occurred in the context of a massive decline in home sale prices or rather in home real estate market prices that almost no financial models contemplated, including the rating agencies, Citi's, or to the best of my knowledge, the regulators.

The board required and received extensive financial and risk reporting but I do not recall knowing before September `07 that these super senior tranches were on our books. I feel confident that the relevant personnel believed in good faith that more senior-level consideration of these particular instruments was unnecessary, because as I said a moment ago, the positions were rated Triple-A and appeared to bear de minimus risk.

In October the rating agencies substantially downgraded these securities and subsequently Citi estimated that it would have a loss of 8 to 11 billion dollars.

When these losses or estimated losses were announced, Chuck Prince decided to step down, Win Bischoff became CEO, I stepped in as chairman of the board, and I worked with employees, clients and others to stabilize the bank, to assist in raising capital during a very difficult period and served on the CEO search committee that led to the selection of Vikram Pandit.

Ultimately, Citi took 30 billion dollars in losses on its super senior CDO positions. These losses were a substantial cause of the bank's financial problems and led to the assistance of the United States government.

I believe that the overriding lesson of financial crisis was that financial system is subject to far more severe downside risk than almost anyone had foreseen. I believe, too, that it is imperative in light of that lesson that private institutions and the government act. Citi, first under Chuck Prince and then under Vikram Pandit, implemented major personnel changes, restructured and improved risk management, and raised huge amounts of capital.

The private solutions are only part of the answer. Financial reform is imperative and should include, one, substantially increased leverage constraints, with one tier based on risk models and a second tier based on simpler -- simpler metrics, because models cannot capture all of reality.

Two, derivatives regulation - I reflected my strong views from my time at Goldman Sachs, that derivatives can create serious systemic risk and that appropriate regulation is needed, a subject I also discussed in my 2003 book.

Three, resolution authority to avoid the moral hazard of too big to fail.

And four, consumer protection, primarily and very importantly to protect American consumers but also to protect the financial system.

With that, I appreciate the opportunity to share my views and would be happy to respond to your questions. Thank you.

CHAIRMAN ANGELIDES: Thank you, Mr. Rubin and Mr. Prince. And let me just reiterate again, we appreciate you being here today; we appreciate your willingness to help us in our endeavor. And Mr. Rubin, let me also just say to you, thank you for your years of service to the country.

So, with that, we are now going to begin a period of questioning by Commissioners, and, as Chairman, I will start off with some questions for both of you and each of you.

So I want to pick up on your comment, Mr. Prince, about whether or not this institution was too big to manage, too complex to understand, perhaps too big to regulate.

Really, for the benefit of people watching today, it appears as though that there are about 51 billion dollars in write-offs related to subprime lending. The institution, as I understand it, is one that went from about 670 billion dollars in assets in about 1998 to 2.2 trillion dollars on balance sheet, another 1.2 trillion dollars off-balance-sheet by 2007. By 2008, the tangible common equity-to-assets ratio we estimate at 61 to 1, with off-balance-sheet 97 to 1.

I really want to ask both of you some very specific questions that get to the heart of the management, the risk of the organization, particularly around subprime lending. Mr. Rubin, I'm going to start with you.

On November 17th of 2007, there was a meeting between executives of Citigroup, including yourself, and you were there briefly, I believe, at the meeting, and then Mr. Bushnell was at the balance of the meeting. This was a meeting with the senior supervisors from the Federal Reserve Bank of New York, the Federal Reserve board, the OCC, the SEC, the UK FSA.

And at that meeting, there are notes about Mr. Bushnell's assessment of what he thought had gone wrong. And he mentioned, among other things, and I might add these are notes, not his exact words, poor communication across businesses, decentralized nature of firm, senior management business line and risk management did not fully appreciate the market risk of the leverage loan pipeline to the retained super senior CDOs.

Corporate-wide stress testing scenario analysis was insufficient. The firm did not have adequate firm-wide consolidated understanding of its risk sensitivity factors. The nature and origin and size of the CDO exposure was surprising to many in senior management.

So as you look at some of those comments, do you think those are a fair reflection? Do you believe that the organization did become too big to manage, the internal controls did break down, Mr. Rubin?

MR. RUBIN: I think, Mr. Chairman, that if you look at Citi prior to the crisis erupting, that David Bushnell ran, at least my impression, ran a very effective, independent risk management capability.

But what David did, as I understand it, and I do remember being a part of that meeting; I don't think I was there for the whole meeting. What David did, and rightly, it seems to me, is after the crisis emerged -- and when I ran Goldman Sachs, we did this every time we had trouble -- he looked back on what he could learn from the circumstances that existed.

And while I don't remember the specific comments that you just made I do remember that there was a conclusion that Citi could do a better job bringing together the risk exposures across the various product areas and David's obsessive function focused more on that.

Well, I guess my answer, Mr. Chairman, is I don't believe that Citi is too big to manage. But I do think that every time you go through, in this case it was a crisis at Citi, but when I was running Goldman Sachs or involved in co-managing Goldman Sachs, we had times we had very, very difficult developments in the trading areas. And every time that happened, we would look back and we would learn how to try to do things better. And I think that was what David was doing in the comments or, rather, was reflecting in the comments that you just repeated.

CHAIRMAN ANGELIDES: All right. Let me ask you a related question, Mr. Prince. For the sake of efficiency, I'll try to move back and forth between the two of you.

On October 30th Mr. Bushnell made a presentation, I believe to the board, of course I'll verify that, but the essence of this is he had a timeline of key events in the subprime market. In fact, I believe it was to certainly senior management. He noted that on February 27th of 2007, that HSBC had announced major mortgage delinquencies and losses related to that; on 6/12, June

12th, my birthday, 2007, Bear Stearns' outside management, it was announced that their funds were in significant problems.

I knew you would want to know my birthday, Mr. Vice Chairman, so you could note it on your tickler.

On July 10th, S&P and Moody's announced significant CDO ratings changes and major downgrades.

On August 10th, BNP Paribas froze its funds, and for the first time Countrywide announced significant problems.

Mr. Prince, I would ask you, because both you and Mr. Rubin have said you really became aware, and Mr. Rubin did in September and I think you said the same thing, of problems in the CDO desk. When all these things happened, why didn't the potential of problems rise to the top in the wake of these major announcements? Why didn't it bubble up?

MR. PRINCE: Well, Mr. Chairman, I think you have to go back to the time in question. So much has happened since then that it's a little hard to put yourself back in the timeframe of what just happened. And I can only speak for what people must have been thinking, because I obviously didn't know about the CDO positions and the timeframes that you're talking about. But I believe in hindsight that people believed, and they believed with a level of certainty that it's hard to appreciate today, that the super senior tranches would never be touched by these problems. So the various rating changes you talked about were for the lower level, the not super senior tranches.

Now again, sitting here today, that belief looks pretty unwise, but I think at the time, Moody's was quoted as saying that these problems would never reach the super seniors. And I think people believed that the structuring process had gotten to a point where that top level would be immune from the problems that were being seen at the lower levels.

And I'm not saying that's right; it obviously turned out to be wrong, but I believe that's what they believed at the time.

CHAIRMAN ANGELIDES: Well, let me probe that a little, because Mr. Georgiou raised this yesterday. The very nature of the CDOs, which is they were a, essentially, a collection of the lower tranches of the residential mortgage-backed securities.

And I -- I want to attribute this to Mr. Georgiou that there was an element here of taking lead and turning it into gold. You had a number of lower-rated tranches that if you add a pile of stuff, and that's probably a charitable description, you take the lower stuff, now you put it at the top, and all of a sudden, that's highly rated.

Interestingly enough, by the fourth quarter of `07, housing prices had only fallen 5 percent. And just for reflection, in `90, `91, on a cumulative basis in this country, housing prices had fallen 3 percent, of course particularly driven by places where I lived, California, Florida, Texas. But by that fourth quarter, you had already written down 18 billion. So clearly those super senior tranches were touched fairly quickly because, in essence, they weren't truly the Triple-A. They were elevated in that structure.

So I guess the related question is, to what extent did you ever do any at the board level, and I know you said at one point, which I think reflects on the scale of the institution, that putting on a 2-trillion-dollar balance sheet 40 billion dollars of a Triple-A-rated zero risk paper that that would not have in any way excited my attention.

At any point did either of you gentlemen look at the nature of these instruments and say, I'm troubled about the nature of taking this subpar stuff and rating it at the top? Did you ever do the analysis, essentially, the hard analysis of the underlying collateral? Mr. Rubin?

MR. RUBIN: Mr. Chairman, and I'll reflect back, if I may, just in response to your question, for a moment, on the days when I ran Goldman Sachs.

When you're running a large organization, or I'd say even a medium-sized organization, what you can do is you can look at the people you have in place, you can look at the aggregations of risk, which the Citi had done very well by David Bushnell, but there isn't a way in an institution that has hundreds of thousands of transactions a day and probably something over a trillion dollars a day running through it, that you're going to know what's in those position books.

And I didn't know it when I was running Goldman Sachs, and you wouldn't know it sitting on the board of Citi either. You really are depending on the people who are there to bring you problems when they -- when they exist.

In this case you're talking about a level of granularity that no board will ever have with respect to the positions that are in -- that are in its books, which is why a board has such a strong responsibility to make sure that they have the right people in the right places.

CHAIRMAN ANGELIDES: Not to interrupt, you did have weekly business meetings, which you both attended, of the business heads.

MR. RUBIN: Yeah, but the business heads -- absolutely correct.

CHAIRMAN ANGELIDES: And it does seem to me, I know that 40 billion dollars may sound like chump change in this organization, but it seems to me like a fairly significant initiative to have 40 billion dollars of exposure.

I mean, it's not that it's so -- and I might add, you know, in the RMBS arena, I think you guys were doing about 90 billion dollars' worth of securitization, you weren't light in this arena. So I'm just curious about the depth of strategic discussion around the positions and mortgage-backed security and the underlying collateral.

MR. RUBIN: Yeah, but if I may say something, Mr. Chairman?

CHAIRMAN ANGELIDES: Yeah.

MR. RUBIN: We had the strategic discussions about, at the business heads meetings, about P&Ls and the operation of the business one thing or another. But individual positions only came to that meeting when either independent risk management or the people running the businesses felt that there were problems.

And in this case, they were dealing with, as we now discussed many times, Triple-A securities that were deemed to be de minimus in risk. And these simply were not brought to that meeting.

If I had to make a guess, and I do not know, my guess is that the people who structured these did a probabilistic analysis and determined that even though as you correctly say, the individual securities within them were not of the quality of the totality if you will, that with the structures that they had, that the risk became de minimus.

I seem to remember, because they not only depend on the Triple-A as you know, they did a lot of their own independent work. And I seem to remember seeing someplace, much more recently, that they calculated the risk for something like one in 10,000.

CHAIRMAN ANGELIDES: Well, that's what their models showed. Yeah.

MR. RUBIN: Yeah, what their models shows, and it's sort of --

CHAIRMAN ANGELIDES: But I really question the models if you only have a 5 percent price drop, you write off 18 billion.

MR. RUBIN: Look, there's no question, Mr. Chairman, that once developments became or started to become adverse the -- these securities got -- incurred considerable difficulty. And, in hindsight, obviously, there were real problems. But I was trying to speak of them as of the time that these positions were taken and as they were seen at that time.

CHAIRMAN ANGELIDES: Let me ask you a couple of quick yes-or-no questions to move along here.

You had, Mr. Prince, you -- you indicated you had about 11 billion dollars' worth of warehouse lines out to subprime originators.

MR. PRINCE: I'm sorry?

CHAIRMAN ANGELIDES: Eleven, you had about 11 billion dollars, you've acknowledged in your interview with us that you became aware fairly late in the game, you said, I found out at the end of my tenure -- this is about the 11 billion dollars in warehouse lines that supported some very aggressive subprime lenders, about 26 of them, and you said, I did not know before, I think getting that close to the origination function, being that involved in the deracination of some of these products is something I wasn't comfortable with.

Mr. Rubin, did you know that the bank had a very significant 11-billion-dollar extension of credit to very aggressive subprime lenders? Is that something of which you had awareness?

MR. RUBIN: I certainly don't remember today whether I knew at the time or not. I honest -- I truly don't, Mr. Chairman.

CHAIRMAN ANGELIDES: Let me ask you, Mr. Rubin, one more question specifically, and I want to go to one final issue before I, at least at this point, turn to the other members.

Yesterday we had before us Mr. Bowen, who was, I believe, chief risk officer, his title, he was in the business underwriting unit in the risk function.

He had -- had tried unsuccessfully to get his superiors to move on some concerns he had, and then on November 3rd, `07, sent you an e-mail. He was concerned about the inaccurate adequacy of the sampling size for loans that Citi was buying and then selling to Fannie and Freddie.

The sample size, according to your policy, should have been 5 percent. It was consistently less than 2 percent. But in addition to that, he found that 40 to 60 percent of the sample files failed to meet the minimum contractual underwriting criteria of the originator or had information missing and a fail rate that was not accurately being reported. He also found that that failure rate rose to 80 percent.

Did you ever act -- that was sent to you, Mr. Bushnell, and I believe some other individuals. Did you ever -- it was sent to, yes, you, by Mr. Bushnell, Mr. Crittendon, and Ms. Howard. Did you ever act on that?

MR. RUBIN: Mr. Chairman, I do recollect this and that either I or somebody else, and I truly do not remember who, but either I or somebody else sent it to the appropriate people, and I do know factually that that was acted on promptly and actions were taken in response to it.

CHAIRMAN ANGELIDES: All right. Could you please get us, back to us, perhaps, you know, you and/or the people existing at the company today, back to the Commission exactly how Citi responded and when it responded and what it did?

MR. RUBIN: I would be very happy to, and I believe legal counsel at Citi has -- in fact, I know they do, has that information.

CHAIRMAN ANGELIDES: All right, last set of questions for you before I yield the right to go on to other members, and I will come back at the very tail end, but I want to ask you about sequence of events, and here they are.

Both of you have said that you didn't become aware of the CDO exposures until September, I believe. And as I understand by looking at documents, by looking at the interviews you did with our staff, that you learned in early September, which point you started, Mr. Prince, a series of meetings and, later, nightly calls that became known as the Defcon calls.

And I think the first meeting was on September 9th. Mr. Rubin was in Korea, but he was in touch by e-mail. And then, Mr. Rubin, you joined these I guess very extensive calls that happened over time.

And I think you said, Mr. Rubin, on September 12th, when the CD -- CDOs really become a focus of your discussions, but here's -- I want to just ask you about a sequence here.

On October 1st, Citigroup preannounces its third-quarter earnings, and I believe indicates a 13-billion-dollar exposure to subprime, including a billion-dollar write-down related to subprime-related CDOs. On October 11th, there's some rating agency downgrades.

MR. RUBIN: What was that date, Mr. Chairman?

CHAIRMAN ANGELIDES: I believe October 11th, the second date. But then here's what I want to ask you about. Apparently you became aware mid-September; October 1st, you announce that you are announcing your exposure's 13 billion, but here's what happens, at least according to records I've seen, and I certainly will give an opportunity for you and your folks to review these to make sure we have the chronology right, and maybe I should ask the question.

It appears that on October 15th, two things happened. The first is that there is a call with analysts in which Mr. Crittendon tells analysts and the public that Citigroup has a 13-billion-dollar subprime exposure.

However, on the same day, a presentation is made to the corporate audit and risk management committee and then to the board of directors, and as part of that there's a presentation on risk management, and it says, quote, the total subprime exposure in markets and banking was

13 billion dollars, with an additional 16 billion dollars in direct super senior, and 27 billion dollars in liquidity and par puts.

So on the same day that the public's being informed it's 13 billion, the board and the audit committee are being told that this adds up to, frankly, more than 50 billion, I believe 55 is the total math here roughly, at which point, on November 3rd, you have an emergency board of directors, and on November 4th you announce the 55 billion dollar exposure, and Mr. Prince, I believe that's the day in which you announce your resignation.

I guess what I want to ask is, why is there an announcement made to the public that it's 13 billion at the same time that that board and the audit, risk and audit committee, are being told that it's substantially more? And I think, Mr. Prince, I'll ask you and then Mr. Rubin.

MR. PRINCE: Well, Mr. Chairman, I think that you've asked a very detailed factual question referring to documents and presentations and so forth, and I would have to look at those and compare them pretty carefully to answer it in the level of detail in which you've asked it. But I think that at the time, the financial people were working very intensely with the fixed-income people to try to determine exposures in this area.

This was an unprecedented time in which markets were crashing and rating agencies were pulling supports out of longstanding structures. And I think that the -- that their view of what the exposure was to subprime changed during that period of time as these events happened.

Now, you just quoted from a presentation. And it sounds to me as if, just listening to what you read, that the presentation was structured in a way to say that our subprime exposure was X, but don't forget we have these other things. And perhaps that reflects their thinking at the time.

But, again, I would have to look very carefully at the comparisons you're making to be able to answer the question in as detailed a way as you've asked it.

CHAIRMAN ANGELIDES: All right. Well, we will provide this to you. Actually, let me just say it's on page 1. This is called Risk Management Review, an update to the corporate audit and risk committee, and it says the total subprime exposure in markets and banking was 13 billion dollars. It's right in the executive summary. It's right at the top, under the heading Subprime.

It says, the total subprime exposure markets and banking was 13 billion with an additional 16 billion in direct super senior and 27 billion in liquidity and power puts. All right, Mr. Rubin, and then we'll move on to other members.

MR. RUBIN: Yeah. Mr. Chairman, I don't remember the presentation, but I could give you what I suspect was the case, if I may, and you can confirm this for yourself.

I might, as I say, I don't remember the presentation, but it strikes me as understandable in the context of how those positions were then being seen, which is to say that the 13 billion, I would guess, was subprime exposure below the Triple-A super seniors that we've now discussed a number of times.

And if that was viewed as subprime exposure, that the 43 billion, which is exactly the number that we referred to as the super senior number, wasn't viewed as a subprime exposure, it was viewed as a Triple-A security.

CHAIRMAN ANGELIDES: I will just note, you can look, I don't want to surprise you, I will have you look at the document. It's right up top. It's under subprime.

MR. RUBIN: Oh, it may have been listed under subprime, but I don't think, and, again, I don't remember the meeting and the discussion and I certainly was not part of the formulation of these documents. I think you can find out other ways exactly what these people were thinking.

But my guess would be that they reviewed as two different classes of exposure: One being subprime exposure and the other being because of all of the structuring

Triple-A super seniors.

CHAIRMAN ANGELIDES: All right, let me do this, I may have one or two other questions, but I want to stop now and move on to the vice chair. Thank you very much for your answers to these questions.

Mr. Thomas.

VICE CHAIRMAN THOMAS: Thank you, Mr. Chairman.

EXAMINATION BY VICE CHAIRMAN THOMAS

VICE CHAIRMAN THOMAS: Thank both of you for coming. We appreciate it. As you know, given our charge of trying to understand what happened so that we can convey to the American people what happened is an exceedingly difficult and complex job in which we have a very short period of time.

I want to ask you, we obviously know more today than we did yesterday in this very narrow area, and we're going to know more tomorrow. These hearings are not designed to be exhaustive. And if I ask you, if we had questions, not only relating to the topic that we have before us but other concerns based upon your position and experiences, some very in-depth, others very broad, would you be willing to respond in a timely way to written questions that we might submit to you between now and the end of our statutory journey? Is that an appropriate -- do you have a --

MR. PRINCE: Well, I'm not sure how we could say no, Vice Chairman, so I guess the answer is yes.

CHAIRMAN ANGELIDES: Well --

VICE CHAIRMAN THOMAS: Well, I don't understand how you can explain what you did and how you did it, but it's really easy, because all you do is say yes.

MR. RUBIN: The answer, Mr. Chairman, I agree, Chuck, the answer is yes, we would be delighted to, and that is -- and I'll interpret Mr. --

VICE CHAIRMAN THOMAS: Is that "we" as part of your responsibility at Citi to advise senior or former senior management?

MR. RUBIN: I was expressing my view and interpreting Mr. Prince's view.

VICE CHAIRMAN THOMAS: Could I have your view, Mr. Prince?

MR. PRINCE: Indeed, yes, I would be greatly pleased to do that.

VICE CHAIRMAN THOMAS: Thank you very much. Yesterday's panel, and we spent some time with Mr. Murray Barnes, former managing director, independent risk officer of Citigroup, David Bushnell, as you mentioned, chief risk officer, Nestor Dominguez, former co-head of the Global Collateralization Debt Obligations, Citi Markets & Banking, and Thomas Maheras, who is the former chairman and co-chief executive officer, Citi Markets & Banking.

I woke up this morning, my alarm was set at 5:00, and I have my radio on CSPAN. And I woke up to the voice of Brooksley Born, the Commissioner who was inquiring about, as we began our journey yesterday into this garden of good and evil, about synthetic CDOs and what were they.

And, of course, if you listen to that discussion, it led into Commissioner Byron Georgiou's trying to comprehend how you take a bunch of Triple Bs, slice them and dice them and turn them into Triple-A and Triple-A-plus, the super senior tranches that somehow were never supposed to go bad.

And then I listened to Commissioner Wallison's excellent questioning of the panel leading us to a better understanding of these products that were created to be sold, which meant -- generated millions of dollars, in some years tens of millions of dollars, to then-Citi management, on the way up, but never resulted at any time even in a dollar of clawback on the way down.

So that I finally woke up realizing that, if I had a chance to start my life over, I may very well choose a different path because apparently you get to the top without ever having experienced any of these things that people underneath you do; you don't have a comprehension; you're not informed, but you get to make all this money on the upside and there's no downside.

You folks had an opportunity to submit written testimony, which you did. I don't believe, correct me, Mr. Chairman, there's no limit on the pages of written testimony.

CHAIRMAN ANGELIDES: Not that I'm aware of.

VICE CHAIRMAN THOMAS: There's a limit on the verbal which you can express as you see fit. So what we have in front of us is your written test- -- testimony, that started with a blank sheet of paper and that you were willing to inform us, more or less.

Now, Mr. Prince, I'm looking on page 2 and you say, in the middle of page 2, the patchwork -- quote, the patchwork nature of state regulation of the origination of subprime, indeed, of all mortgages, led in hindsight, to the origination of more and poorer quality subprime assets to be securitized.

Was there a requirement that they be securitized?

MR. PRINCE: Well, I'm not sure I understand your question, Mr. Vice Chairman.

VICE CHAIRMAN THOMAS: Well, there was a demand, as you say a sentence above it, in dealing with this growth of securitized products that you obviously, given your business, wanted to produce securitized assets that had low risk and high yield. Who wouldn't? To the point that you create so-called synthetic products.

But it sounds like you're saying the fault was the state regulation of the origination of subprime because they -- they gave us poor quality subprime assets to be securitized.

You didn't have to do that but you did. And -- and, please, we heard enough yesterday about you starting along a line of argument that others, third parties, gave you assurance that they were okay, rating agencies, others.

Again, how do you get to the top if you don't have any experiential experience, whatsoever, or your argument is, at that point, and you don't pay any attention to it?

What do you get paid for if it isn't having some intuition, understanding, knowledge, or do you just do what everybody else is doing because everybody else is doing it, and if you don't do it, then you won't make money? Because I do think it's all about money. And it was big money on the way up. But never at any point is it on the way back down.

What I'm saying is that when we get this -- when I get, and I'll speak for myself, this kind of an argument as to what happened, in hindsight, it's listening to someone blame the inferior quality of leather in a pair of shoes based on the feed that some person supplied to a FINRA feeding the cattle that produced the leather.

I have to tell you, listening to the radio this morning explain what it was that you did with products makes it very, very difficult, notwithstanding a beginning paragraph or two in which I do believe was sincere in terms of your concern about what happened, but in this entire process, not one dollar of clawback.

Mr. Rubin?

MR. RUBIN: Well, there were a lot of pieces --

VICE CHAIRMAN THOMAS: I -- I -- I have a question.

MR. RUBIN: Oh, I'm sorry. I apologize.

VICE CHAIRMAN THOMAS: That was a statement but if anybody wants to turn it into a question, they can.

MR. RUBIN: Okay.

VICE CHAIRMAN THOMAS: You have -- you started with a blank sheet of paper as well. I do like the latter pages where you go into that analysis of some things that we need to work on. I think you've got some core stuff that I think we're all talking about.

And you know as well as I do that when you talk about financial services legislation moving through the Congress that committee jurisdictions limit what they can look at and it's going to be a long and difficult process.

What I want to focus on is that for the first time in these hearings, someone has introduced of their own volition, in the comments that they've offered to the Commission, some partisan comments.

In one, two, three, in the fourth paragraph, you state, it's important to remember, quote, it's important to remember that our national economic policies enormously affect all of us. For example, President Clinton undertook deficit reduction and made critical public investments. And those policies contributed to the longest economic expansion in American history, simply put, policy matters.

Well, so does the truth. I -- you came in at the beginning of the Clinton Administration and actually before the President was sworn in, in December of `92, and the President was sworn in, in January of `93, and he became President with a democratic Congress and a democratic majority in the House of Representatives.

The House of Representatives is that branch of the legislature, the national legislature, which in Article 1, Section 8, has sole responsibility for the generation of revenue legislation. It is the place that controls the nation's purse strings.

Just before you were sworn in as Secretary of the Treasury, January 11th, 1995, for your three years of experience as Treasurer, on January 3rd I was sworn in for the ninth time into the House of Representatives and for the first time in four decades as part of a Republican majority in the House of Representatives.

And so I guess I'm a -- I'm a little -- I'm a little personally concerned that if anybody looks at the election of November of 1944 it was over the tax and spend policies of the Democratic administration and the Democratic majority, principally, those who controlled the purse strings in the House of Representatives.

And the American voters in that election, just prior to your becoming Treasurer, rejected those policies and voted out as a majority those members of the Democratic party.

So if there was deficit reduction, as a policy, and critical public investments for six of the eight years of the Clinton Administration, three-quarters of that administration's policymaking, it was with a Republican majority in the House of Representatives that controls the purse strings.

And you know the punch line. I was on the committee that controls the purse strings, and so I guess I'm a little concerned that the continued representation of what I would call a half truth doesn't serve our needs today.

And I -- and I -- I know this is a partisan statement surprisingly, that the fact that it became bipartisan to have to make public policy, I believe worked to the benefit of the American people.

There's been great criticism by the current majority, both in the administration and the Congress, about the unilateral control of the Presidency and the Congress for a period of time by the Republicans. And I'm concerned about the current return of structure of the current non-bipartisan arrangement.

So if you would, just as you were writing there, uncharacteristically, given a little bit of credit to the fact that just prior to your signing in, you knew you were going to have to work with a House of Representatives controlled by another party, which I think ultimately, in the American political tradition of accommodation and compromise, moved some pretty good policy.

And, yes, the President signed it, but he would have had nothing to sign if it hadn't been advanced by a Congress with a House of Representatives controlling the purse strings run by a Republican majority.

MR. RUBIN: Is it possible for me to respond to that?

VICE CHAIRMAN THOMAS: You sure can.

MR. RUBIN: Okay. Let me first assure you --

VICE CHAIRMAN THOMAS: You can -- you can add an addendum to your opening statement, if you want to.

MR. RUBIN: No. Let me -- let me just very briefly respond to pieces of that, if I may.

I certainly didn't mean it to be a partisan comment. I was trying to make a point about public policy. But I'll give you my view of the secrets if you say I'll just take one moment since it doesn't relate to the crisis, but in `93 we did have a deficit reduction program, and it was powerful, and it set the stage, in my opinion, for eight years of fiscal discipline.

The `94 election just came out exactly as you said. I don't personally think it was about the `93 decision. I think it was about a lot of other matters, but that's a political issue.

And you were absolutely correct in saying that in 1997, the Republicans and Democrats worked together in a bipartisan fashion, beginning, as you correctly say, in the House of Representatives, for the reasons that you describe, to arrive at a balanced budget agreement, which carried forward the work that at least in my judgment, began in 1993. So that would be my summary of that, that period.

VICE CHAIRMAN THOMAS: I appreciate that.

Mr. Prince, so I want you to comment, if you would, because I don't know you personally and I only knew you from, to a certain extent, a comment that's obviously gotten far more coverage than it should have if, in fact, you made it, and I assume, knowing the press only reports those things that occur, that you made it at some point about the business of if they're playing the music you have to dance. No, you don't.

Now, I understand there probably would have been consequences. Maybe somebody would have not continued to make tens of millions. But when you listen I just have to commend everyone that the audio, not the video, the audio of the dialogue between the questioning of the Commissioners and the answer from those people in Citibank who were in a position to make up all these things and have a knowledge, I understand that you're at the top, but these were the people who were not.

And the creations that you made, arguably driven by the desire of markets, and your job is to make markets, and your argument is we didn't know, you didn't understand, had we known then.

At -- at some point, is it necessary, in your opinion, to create a structure which stops you from doing things? Because I don't think any of us want to create that kind of a structure, requires you to what you're doing -- I believe sunshine's a great disinfectant, that there's complete transparency, that you need third parties to -- to have an understanding of whether or not they would buy it?

More importantly, should you have to have money, notwithstanding that you were adequately capitalized under some regulations that were created prior to the environment that we were in, what, probably, looking back, because you now have hindsight, would you have preferred that was comfortable to allow you to carry on your business, but nevertheless, I don't believe in simply imposing structures for the sake of controlling.

I don't want to kill the goose that mostly laid golden eggs. You laid other eggs but some of them were golden. And I think it's absolutely necessary. Your point about national and international, we can't go back.

I'm very concerned that we address problems in the United States and we don't get a successful and negotiated agreement internationally, which doesn't advance our need to control.

Given the nature of your company in terms of its significant international involvement, what could have been done that would have made it possible for you to carry on aspects of business that makes sense but would have limited, controlled, mitigated, but you wound up doing?

MR. PRINCE: There's a lot there, if I may. Let me just respond to the quote that you mentioned.

VICE CHAIRMAN THOMAS: No, it's the alleged quote that I read in the media, because I never heard it.

MR. PRINCE: Well, you were in Japan, so that's why you didn't hear it directly. And I would appreciate the courtesy of quoting the entire quote. The entire quote started with the statement that when the liquidity dried up, the financial environment would become very complicated, but that as long as the music was playing, you had to get up and dance.

Now, I think that reflects --

VICE CHAIRMAN THOMAS: Just let me say, Mr. Prince --

MR. PRINCE: Can I finish my answer, please?

VICE CHAIRMAN THOMAS: -- I'm not surprised that the entire quote was not printed, given my background and experience.

MR. PRINCE: Well, it actually was printed in many places. If I can just finish my answer?

I think I've been quoted in Secretary Paulson's book, at about the same time as asking the regulators to impose limitations on the companies so that they would not be engaging in some of these activities.

I want to emphasize that this was about leveraged lending; it had nothing to do with the mortgage business. It had nothing to do with the CDO business, it had nothing to do with the issues that we've been talking about here.

But in terms of the quote itself. The quote itself related to the leveraged lending business, and I specifically asked the regulators if they would take action in regard to that.

VICE CHAIRMAN THOMAS: You started off your statement in using the term you wanted the regulators to impose? So you wanted them to stop you from dancing?

Can't -- can't you set up structures inside, or is it that you would feel then you had a -- you -- if you limited yourself, others would not? And that's the origination of imposed. So it was imposed on everyone because none of you can regulate yourself in terms of creating these triple synthetic, Triple-B, the Triple-A senior tranches that are never, ever going to go down?

MR. PRINCE: Sir, you must have misunderstood me. I apologize.

As I said, this had nothing to do with the mortgage business. This had to do with the leveraged lending business. In the summer of 2007, the leveraged lending business, banks lending to private equity firms, was a matter of great topic, a matter of great discussion.

And at that point in time, because interest rates had been so low for so long, the private equity firms were driving very hard bargains with the banks. And at that point in time the banks individually had no credibility to stop participating in this lending business.

It was not credible for one institution to unilaterally back away from this leveraged lending business. It was in that context that I suggested that all of us, we were all regulated entities, that the regulators had an interest in tightening up lending standards in the leveraged lending area.

But again, I want to say, for the third or fourth time, it had nothing at all to do with the mortgage business.

VICE CHAIRMAN THOMAS: Thanks. In other words, you weren't going to be the lemming that stopped and said that I don't know if I want to keep walking. Thanks.

CHAIRMAN ANGELIDES: All right. Ms. Murren?

COMMISSIONER MURREN: Thank you.

EXAMINATION BY COMMISSIONER MURREN

COMMISSIONER MURREN: Thanks to you both for being here today.

I want to follow on the thread of that conversation, because you and many of the people that were here to testify yesterday have alluded to the fact that they were not rewarded for growth, that they weren't rewarded for revenue growth or for earnings growth, that that was secondary in the way they were compensated; am I wrong? Did I misunderstand that?

MR. PRINCE: I'm not sure who you're quoting. I apologize.

COMMISSIONER MURREN: Did you not say earlier in your testimony that part of your major driving force in your compensation was not revenue growth?

MR. PRINCE: In my statement, Commissioner, what I said was that the risk function, the risk function, was not compensated on -- on revenue growth or profit growth. The risk function as an independent control function was not compensated based on business volumes.

COMMISSIONER MURREN: Okay. Thank you for that clarification, that's -- that is logical. The follow on to that would be how do you then try to factor in risk into the way that you compensate all of your executives?

And because what I hear in a little bit of this notion of if people are dancing, you need to dance too, is when you think about compensation, oftentimes people are rewarded because of the way they're compared to their industry.

So then it's very difficult for any manager in any position to be able to say, no, we don't want to grow in this business because inevitably, at the end of the year, you will be compared to entities perhaps that are growing, perhaps unwisely.

And I would like your comments, perhaps, on if there is a way that things might have been structured differently so that those decisions would have been easier for people to make.

MR. PRINCE: That's a very thoughtful question. The compensation structure on Wall Street is -- is one that many people have criticized over the years. It is for -- for traders, for bankers and so forth, a compensation model that is based on revenue growth, not even profit growth.

And a number of people over the years, Warren Buffet among them, has tried to change that compensation model on Wall Street.

Let me tell you, if I may, how compensation worked for me. I spent nearly 30 years with Citi and its predecessors, and over that period of time, certainly when I was an executive of the company, we were paid in fair amount in stock of the company. More than half of our pay was in common stock of the company. And for a period of time we were required to hold 75 percent of the stock we received; in other words, we couldn't cash it out. In my case, I held 100 percent of the stock, not the 75 percent.

Our rules also provided that you had to hold the stock as long as you were with the company. You could sell it when you left. In my case, I held the stock the entire time.

As I sit here today, I hold virtually every share of stock I acquired over a nearly 30-year career. And I watched it go from $50 a share to $30 a share to less than a dollar a share.

So in my case, I think my interests were aligned a hundred percent with stockholders. I watched a great majority of my personal net worth built up over 30 years disappear, because my company suffered from these problems.

Now, I can't speak for others. I can't speak for whether other people cashed out. But I think a model that requires you to have that kind of alignment with the stockholders is a good one.

COMMISSIONER MURREN: It is good, in certain respects, but I would guess that you would agree that there's certain elements of that that would also themselves encourage risk-taking.

For example, when you look at the expectations and how Wall Street expectations play out in the prices of equity, in particular, they typically are related very directly to revenue and profit growth returns on equity which, by definition, mean you're going to want to lever up.

So, then, is there -- and even -- perhaps this isn't the time to discuss it, but my point simply is risk, itself, and the assumption of liability was not necessarily the norm in how people's compensation was determined. There were people that cashed out. There were people actually whose cash pay was substantial enough to accommodate any declines in the stock price should they occur.

So I think that it would be fair to say that there is, in my view perhaps, some greater emphasis on growth than perhaps is healthy, at the corporate level; would you not agree?

MR. PRINCE: Well, clearly you can't overstate the need for risk assessments in running your business. But I want to emphasize, if I may, that the CDO positions that we're talking about were not put on the books by people who were trying to take on more risk. They thought, they were mistaken, but they thought they were taking on little or no risk.

So very clearly, from the Commission's standpoint, the notion of making sure that risk considerations are embedded in the operation of a business is absolutely a high criteria, I grant you that. But I think it is a more complicated issue in this case, because the folks involved did not think they were reaching in a risk standpoint, so risk parameters weren't violated.

Now, in hindsight, it's been horrible, I accept that, but at the time, on a prescriptive basis, going forward, as the Commission needs to struggle with, the notion of having stronger risk parameters, as such, wouldn't, by itself, go to the essence, I believe, of what happened here.

COMMISSIONER MURREN: The financial services sector, though, is uniquely complex and has a regulatory structure that is designed to help companies, in this instance, because of risk-focused regulation manage their own systems of risk.

And I'm interested in your comment, Mr. Rubin, about the notion that you were in a position, both of you, I guess, but perhaps just you, to have people surface problems to you as they occurred.

But wouldn't it also be true to say that you and the regulators that oversee your business, to ensure safety and soundness, should have been asking the right questions. And, from your perspective, I would be interested in your description of your interaction with the various regulatory agencies, and also to what extent you felt that they were asking the right questions at the right time.

MR. RUBIN: Yeah, Commissioner, I think I may have slightly misstated what I -- I may have slightly misspoken or there may have been a misunderstanding.

No, I didn't say that I was in a particular position to have issues raised. What I said was that a -- a board cannot know what's in the position books of a financial services firm.

I've been on three public boards. Two were not in the financial sector, and that was true there too. You're not going to know what, on a granular level, what's happening in a business.

So what you need to do, what a board needs to do and I believe Citigroup did do, is to put strong people in the relevant positions. And then what you're depending on is both those people and a whole set of checks and balances, an internal auditor, a CFO, legal counsel and the rest, to surface problems when they exist. And that was what I had alluded to.

COMMISSIONER MURREN: And in the instance of Citigroup --

MR. RUBIN: Right.

COMMISSIONER MURREN: -- observers would say that that was not present, that the internal communications necessary for that to work effectively weren't there, the infrastructure wasn't there, properly allocated and properly executed for risk management.

But you have said that this isn't true. Given the outcome, do you think that there was a way for you to have done that better and do you think that the regulators should have noted that more strongly in what they did?

MR. RUBIN: I don't agree with the -- with the -- I don't think that's right, Commissioner, in terms of the -- the processes as not being there.

We had the board meetings, I guess, roughly speaking, once every month or thereabouts, and the independent risk management people reported both to the audit committee and to the board, certainly in writing and very often verbally, and I think we actually had very robust processes around reporting risk.

As Mr. Prince said, in the instance that we're talking about, you had a particular set of instruments, these Triple-A instruments, that simply weren't viewed, and I think understandably, given the way Triple-A had been viewed in the entire time, in the many decades I was in the industry --

COMMISSIONER MURREN: But we're talking about --

MR. RUBIN: They weren't viewed --

COMMISSIONER MURREN: -- processes.

MR. RUBIN: Yeah. No, I think the processes were very strong. I think you had a -- you had a -- well, can I say, Commissioner, you had a very well-regarded head of risk management.

You had, I think, something like 2500 people or thereabouts that worked in this area, and he presented to both the audit committee and to the board at every meeting.

COMMISSIONER MURREN: So let's talk about the regulators for a second.

MR. RUBIN: Yes, ma'am.

COMMISSIONER MURREN: Your interactions with them, do you feel that they asked the right questions at the right times? Do you feel like your interactions with them were the kinds of things that would support every agency feeding back to the Federal Reserve about the safety and soundness of your enterprise? Do you think that that worked effectively?

MR. RUBIN: Commissioner, I was not personally involved -- given my role in the institutions, which I described in my statement, I was not involved in the interactions between the company and the regulators, so I can't answer that.

COMMISSIONER MURREN: And you, Mr. Prince?

MR. PRINCE: Well, I was, and I -- I -- Commissioner, I would describe it as follows: The regulators were embedded in the organization; that is to say, they were representatives of the regulators, the various regulators, who had offices in our building and who worked there on a daily basis.

In addition to that are various staff functions, the risk function, the audit function, the legal function would meet with the regulators on a periodic basis. And without knowing every meeting, my guess is it was at least once a month.

I would personally meet with regulators on a frequent basis, at least once a quarter, sometimes on a private basis. I think that what happened here is that the regulators also mistook the ultimate safety of the CDO positions. I don't think it was a situation where the regulators weren't active. It certainly felt active from the company's standpoint.

I don't think it was a situation where the regulators didn't know what was going on. As I said, they lived with us day by day by day. I think that the mistake that was made by everyone about the value of these instruments was fundamentally also made by the regulators. And I think that's basically what happened.

I don't think it was a failure of regulatory involvement with the company.

COMMISSIONER MURREN: Thank you. Concede my time.

CHAIRMAN ANGELIDES: Thank you very much, Ms. Murren.

Mr. Wallison?

COMMISSIONER WALLISON: Thank you, Mr. Chairman.

EXAMINATION BY COMMISSIONER WALLISON

COMMISSIONER WALLISON: Let me start with you, Mr. Prince. I want to thank both of you for coming to this and answering our questions.

Let me start with you, though, Mr. Prince. You talked about --

CHAIRMAN ANGELIDES: Mr. Wallison, pull the mic a little closer to you, I think for everyone, so we can hear your mellifluous --

COMMISSIONER WALLISON: Mellifluous.

CHAIRMAN ANGELIDES: Sorry about that.

COMMISSIONER WALLISON: Okay.

CHAIRMAN ANGELIDES: Easy for me to say.

COMMISSIONER WALLISON: Mr. Prince, you talked about a 30 percent decline in housing prices, completely unprecedented event, and you talked about it as though it was kind of in the common talk today; like a black swan, it just sort of happened.

Have you considered why it happened? Have you given any thought to that, and if you have, would you describe to us what your thinking is?

MR. PRINCE: Well, I have given that some thought, as you would imagine. I know that for a period of time before the financial crisis, David Bushnell would say, you know, our stress testing is X or Y, and we would have to have a decline of X or Y, and we haven't had that since the Great Depression.

And I thought about why in this time period we had such a huge decline. How could that be the case? I'm certainly not an in-depth expert on the mortgage market.

But my guess is that the period of time before the crisis in which home prices appreciated so much and in which so much expansion of lending occurred could be seen as a bubble period in housing as well as other things.

So that if you were to draw a trend line that would go up at a certain number of degrees, that because of the easy money and other factors, that trend line in housing would have accelerated very quickly.

So instead of going up at a steady incline, it -- it went up at a rapid incline. And I think that coming back down, on the other side of that, is the 30 percent kind of number that we see.

COMMISSIONER WALLISON: Well, we've --

MR. PRINCE: So that the decline is in some way a function --

COMMISSIONER WALLISON: Sure.

MR. PRINCE: -- of the increase.

COMMISSIONER WALLISON: Well, we've had bubbles before. We've had, perhaps not quite as large as this one; this was a very large bubble, but we've had them before.

But when they deflated, the mortgage failures, as probably Mr. Bushnell told you, were not substantial. They certainly were not 30 percent; it was certainly not a 30 percent decline in housing values.

Were you aware, for example, that in this particular bubble, 26 million, 27 million really, of mortgages were subprime or Alt-A; that is to say, they were ready to fail as soon as the bubble deflated?

Now, when I asked Mr. Bushnell that yesterday, he was not aware of it. I asked some of the other people at the table yesterday whether they were aware of it, and they were not aware of it.

This is -- when Alan Greenspan testified, however, he mentioned that there were 12 million mortgages that were made by Fannie Mae and Freddie Mac that were not reported as Alt-A or subprime by them. So people were not aware that a very substantial number -- almost half of all of the bad mortgages in the economy at that time were made by Fannie and Freddie and were either guaranteed by them or on their books.

Now, would it have -- would it make it somewhat clearer to you why this happened, why we had a 30 percent decline in housing prices if you understood or knew, at the time, that so many of the mortgages, half of all mortgages in our financial system were of poor quality?

MR. PRINCE: Well, Commissioner, it's hard to put yourself back, mentally, at that timeframe, after all that's happened.

The events over the last couple of years color one's thinking. It's hard, now, to -- to think of a subprime loan as not being a, quote, bad loan. But -- but I'm not sure that was the case at the time. I'm not sure that from a policy standpoint, from a lending standpoint, subprime loans were necessarily equated to bad loans.

COMMISSIONER WALLISON: I'm -- I'm really very happy that you said that, because that is exactly right, and that's the point I think I would like everyone to understand.

Most people were very proud of the fact, especially here in this building, and elsewhere in Washington were very proud of the fact that subprime loans were being made and the -- and the home ownership rate in this country was going up during this period.

Now, when it turns out that these mortgages failed and caused, I believe, at least there are indications that they caused the financial crisis, everyone is running away from it and trying to point fingers at who made these loans.

But we have to remember that 64 percent, there was a 64 percent home ownership rate in 19 -- in 1994, but by 2005, and I'm talking about two administrations here, the Clinton Administration and the Bush Administration, it had gone up to 69 percent. And everyone was very proud of this.

So I think we have to look at this as a question of government policy and not a question of casting blame on people who happen to be involved at the time.

Let me go to one other subject: The National Community Reinvestment Coalition says in their annual report in 2007 that over 4 and a half trillion dollars in CRA, that is, Community Reinvestment Act commitments, were made by banks in connection with efforts to get approvals from regulators for mergers.

You were much involved, I think, in this, as the general counsel of Citi, for a while. And Citi's commitments, if I recall the number correctly, was something like 400, 500 billion dollars, somewhere between 400 and 500 billion dollars.

Are you familiar with the fact that these commitments were made in connection with applications to the Fed or to another regulator for approval of a merger?

MR. PRINCE: Well, that's a long time ago, but I would say in a general sense, yes.

COMMISSIONER WALLISON: And while you were at Citi there were announcements that these commitments were being met; that is to say, that they were made and now these loans that actually been made in order to provide financing for people to buy homes. Were they, in fact, made?

MR. PRINCE: Well, Commissioner, I'm -- I'm -- I'm confident that the commitments that the company made in the CRA -- CRA area were -- were fulfilled, yes. I don't know the details, but I'm absolutely confident.

COMMISSIONER WALLISON: Understood. Understood.

MR. PRINCE: We committed we would make these loans and we did.

COMMISSIONER WALLISON: You made them, and the announcement were valid, they, the loans, were actually made. Okay.

I just have one more question for you, and that has to do with the fact that you talked about the downgrade by the rating agencies as being precipitous and causing tremendous turmoil in the markets.

But the downgrade really had one effect and that is it was an accounting effect, wasn't it? I mean, that is to say, once the downgrade occurred then it became necessary for financial institutions that held these mortgages to write them down in some way or take losses on their balance sheets.

I'd just like your views on this whole question of fair value accounting and mark-to-market accounting and the way the -- the accounting rules operated to have an effect on the financial crisis.

MR. PRINCE: Well, that's a -- that's a very broad topic, and I'm sure you could have days of hearings just on mark-to-market accounting.

COMMISSIONER WALLISON: I hope we will.

MR. PRINCE: I wish you well on that.

COMMISSIONER GEORGIOU: Roll call.

MR. PRINCE: And I -- and I hope I'm not here for it, but my basic view on that is that the debate on mark-to-market accounting I think is a false debate. The debate on mark-to-market accounting is either attributed to all mark-to-market accounting or it should be no mark-to-market accounting. And by defining the debate that way, it becomes a very artificial discussion.

In almost every area that we live in, there are moderating factors. If the stock market has a big down day, it has stock limits in it. If a company's pension plan is underfunded, you could fund it over a number of years, et cetera, et cetera, et cetera.

There are very few areas where -- where the absolute nature of today's mark-to-market accounting obtains. There's no question that the mark-to-market accounting is not associated with the cash flow of these instruments. There's no -- there's no question of that.

COMMISSIONER WALLISON: Right.

MR. PRINCE: And it's entirely possible that at some point in the future, people will make a lot of money from these instruments because they will pay out. But, again, the debate now isn't about those kind of issues. The debate is about we have to have mark-to-market accounting as a theoretical purity --

COMMISSIONER WALLISON: Right.

MR. PRINCE: -- or we don't. And I think that's a false debate.

COMMISSIONER WALLISON: Thank you for that answer.

Mr. Rubin, almost everyone who has come before our Commission has testified that the high levels of delinquency and defaults on subprime and Alt-A loans, after the bursting of the bubble in 2007, was one of the preliminary -- was one of the primary causes of the financial crisis.

It was the deterioration, indeed, of these subprime loans that caused the CDO problem that you're so well aware of, so I was a bit surprised that when you listed, oh, almost a dozen items in your testimony as the causes of the financial crisis, the delinquency and defaults on subprime loans was not among them. Why -- why was that?

MR. RUBIN: Well, to some extent, Mr. Commissioner, there was a question of how much I was going to list.

COMMISSIONER WALLISON: You listed a dozen items.

MR. RUBIN: I listed a dozen and said much else at the end, you're right.

But I guess what I was thinking -- what you said was factually correct. What I did was to list the factors that led to the subprime foreclosure rates rather than list the subprime foreclosure rates themselves.

I referred to over leveraging consumers, I referred to excess lending by -- by lenders, I referred, if I remember correctly, to regulatory problems, and I referred to excesses and abuses in mortgage extension.

It was that combination of factors that led or at least contributed greatly to the problems in subprime. You were absolutely correct. I could have said, and all of that led to problems of subprime.

And I instead referred to the factors that led to the problem rather than to that particular consequence of the problem.

COMMISSIONER WALLISON: When you were Secretary of the Treasury, do you recall the housing policies of the Clinton Administration and the strong effort to increase home ownership by increasing the credit available to moderate- and low-income borrowers?

MR. RUBIN: Yes, I do.

COMMISSIONER WALLISON: And those, I assume, you thought were successful, at the time?

MR. RUBIN: I did, indeed.

COMMISSIONER WALLISON: And so you supported those policies?

MR. RUBIN: I did.

COMMISSIONER WALLISON: Between 1994 and 2005, as I mentioned before, the home ownership rate in the United States increased substantially.

Would -- at the time, everyone was very pleased about this, as I mentioned. Would you have gone to Congress, at that point, understanding what you know now, and said to Congress, we have to stop this subprime and Alt-A lending, because sometime in the future it is going to cause us tremendous problems. Would you have gone there, as Secretary of the Treasury, and done that?

MR. RUBIN: No. Let me, if I may give you my view of that, because I think you're raising a very, very important question.

I believe that CRA served very valuable purposes in making credit available to those who would otherwise not have had access to credit, particularly inner-cities. And one reason I mentioned my chairmanship of LISC, as the nation's largest inner-city development organization, is because it relates -- it's that experience that I think has given me some sense of this issue.

What I think we do need and need very badly, I don't think the problem lies in CRA, and I think it's very important to have subprime credit available.

I think where our problem lies is that it's clear, now that we've had this experience, that there were excesses and abuses and substantial excesses and abuses. So I think what we need is to continue with CRA. I think we continue to need, and I think it's very important, to make credit available in inner-cities and corresponding the distressed rural areas. But I do think we need very strong consumer protection, because then you can get at the excesses and the abuses without a problem. I think at least in two respects, if I may, Commissioner.

COMMISSIONER WALLISON: Yes.

MR. RUBIN: I think that we need --

COMMISSIONER WALLISON: If I can get more time. Go ahead.

MR. RUBIN: I apologize. I think we need effective disclosure, but I also think there are some instruments that are inherently susceptible to abuse. And I think serious consideration ought to be given to barring those instruments.

COMMISSIONER WALLISON: All right. I don't think, as I'm agreeing with you in this sense, CRA is not the problem, but Fannie Mae and Freddie Mac have on their balance sheet, had on their balance sheet in 2008, have on their balance sheet probably today, about 12 million subprime and Alt-A loans that we really didn't even understand were on their balance sheet before they disclosed it in 2009. That is one of the reasons we have this problem.

Did you ever attempt when you were Secretary of the Treasury to rein in the kinds of things that Fannie and Freddie were doing at that time?

MR. RUBIN: Commissioner, at the time, let me give you two responses to that, if I may. If you -- if you -- if we have serious consumer protection put in place, then the kinds of loans that you're referring to, if in fact they are the consequence of excesses and abuses, were no longer -- hopefully no longer exist in the subprime loans or mortgages view up on the books of Fannie and Freddie will be sound, at least probabilistically, sound loans.

When I was at --

VICE CHAIRMAN THOMAS: Mr. Chairman, I yield the Commissioner an additional five minutes.

MR. RUBIN: Okay. When I was at Treasury, there were -- we had concerns about Fannie and Freddie. And we particularly had concerns about these very large organizations operating with the implicit guarantee of the federal government.

And the Deputy Treasury-Secretary at the time, Larry Summers, and my successor as Secretary, actually got quite involved in that issue. I was not personally that involved but he was very involved in focusing on those issues.

COMMISSIONER WALLISON: What would be your idea of a loan that would enhance the ability of low and middle income people to buy homes, an affordable housing loan, as it was req- -- as Fannie and Freddie were required to make it that would be a sound loan?

I mean, if you -- if you were going to require organizations as Fannie and Freddie were required to make certain kinds of loans, how can you then say at the same time that if we regulated these loans they would be sound loans rather than the kinds of loans that they seem to have made?

MR. RUBIN: Well, I'm not an expert on mortgage extension, but I -- I -- I think what I would -- this is a first-flash response, and if I had more time to think about it I could probably give you a more comprehensive response, but I think what I would do as part of consumer protection, more generally, not just with respect to Fannie and Freddie, is I would have suitability requirements so that loans could only be extended to people who had -- who were -- who were thought to have the means there but because of their employment assets, whatever else might be, to constitute sound borrowers. And then, as I said a moment ago, I think there are probably certain instruments that I would prohibit.

If it were practical, and I think it may not be financially practical to do this, I do think it would be very important to have some kind of counseling available to low-income borrowers because I think too often borrowers in that position, and as I said, I've seen a lot of this world through the eyes of LISC, which I think handles all this very soundly, I might add.

I think very often, low-income borrowers really are not adequately equipped to make the decisions they need to make. But that may just not be practical. So I would have suitability requirements, I would probably bar certain instruments, and I would have disclosure that was done in such a way that it was readily accessible to people who were not sophisticated.

COMMISSIONER WALLISON: And I assume down payments?

MR. RUBIN: And what?

COMMISSIONER WALLISON: Down payments? Down payments?

MR. RUBIN: Oh, absolutely. I absolutely would have adequate, adequate down payments.

COMMISSIONER WALLISON: Thank you very much.

CHAIRMAN ANGELIDES: That's it?

VICE CHAIRMAN THOMAS: Mr. Chairman?

CHAIRMAN ANGELIDES: Yes?

VICE CHAIRMAN THOMAS: Might I briefly correct the record? Staff has indicated to me in my opening remarks that I said that Republicans gained the majority in the House of Representatives in 1944. No matter how much that might be wished, it isn't true; it was 1994. I want the record to reflect that.

CHAIRMAN ANGELIDES: Mr. Georgiou?

COMMISSIONER GEORGIOU: Thank you, Mr. Chairman.

EXAMINATION BY COMMISSIONER GEORGIOU

COMMISSIONER GEORGIOU: As they say, imitation's the sincerest form of flattery, and recognizing that the Chair and the Vice Chair have stolen some of my thunder regarding the collateralized debt obligation problem, I still feel compelled to return to it briefly, with both of you, if I can, for two -- for at least two reasons.

One is that Citi wrote off more than 30 billion of the 43 billion that you had on the books, which was roughly a third of the capital that the whole bank had at the time.

And second, because I think it's emblematic of something that went seriously wrong in our system that everybody believed was impossible.

I mean, yesterday, we had a panel of your underlings, if you will, who were very serious, high-ranking people within the bank, who sat there, four of them, Messieurs Maheras, Dominguez, Bushnell, and Barnes, and they all made a lot of money, in one instance almost 100 million dollars in the course of the three years before all the troubles hit at Citi.

And notwithstanding that and notwithstanding their respective responsibilities for originating these CDOs, supervising the risk associated with them and all the other aspects of their responsibilities, all of them essentially said that this was inconceivable, unknowable, couldn't have happened, everybody thought it didn't happen, every other institution who was dealing with them had the same view, and so we were hit with this calamity which nobody could have anticipated.

And it seems to me that yesterday I likened it to the medieval alchemy. And today, as I study it more, I'm beginning to believe that maybe it was hallucinatory. I mean, and this is something that I think really deserves exploration, because if you look at the fundamentals, it belies logic. That's not to say that there weren't a lot of people who believed it, but I just want to -- I want to focus -- focus your attention on it yet one more time, if I can.

These RMBS securitizations that occurred resulted -- and this is out of a Goldman Sachs analysis, you know, a post hoc analysis, basically, that 75 percent of the tranches were Triple-A; 10 percent, Double-A; 8 percent, A; 5 percent, Triple-B; and 2 percent equity and the underlying RMBS. So the Triple-B tranches were at the bottom 7 percent of the tranches in the underlying securities.

Now, they take all the Triple-B tranches out of all these underlying RMBS and slice and dice them, and what you get in the collateralized debt obligation is 60 percent of something that's characterized to be Triple-A super senior tranches; 20 percent Triple-A, 6 percent Double-A, 5 percent A, and only 2 percent Triple-B, 2 percent Double-B, and 5 percent equity.

So suddenly you've taken what was the bottom 7 percent of the underlying security and made it, you know, 90 percent of it, more than 90 percent of it above A rated, and it strikes me that the fact that everybody believed this, regulators, Mr. Prince, you mentioned in your testimony, nobody questioned this, is highly troubling, because at the end of the day, this was the most significant single matter that impacted your books and it certainly impacted whole -- the books of a lot of other financial institutions.

So -- so -- and I guess there's a comment that was given to us by a former senior staff member from the Federal Reserve who warned us that the, quote, specious accuracy of complicated financial models should not be trusted.

And basically these models, presumably somebody was modelling this and somebody believed in a modelling that resulted in these analyses, that is, the underwriting people at your shops, the credit rating agencies, the regulators to the extent that they evaluated this, but we now know that everybody was horribly wrong to the tune of over a third of your capital.

So how do we address these kinds of dilemmas I guess is -- is what I put to you? And maybe, Mr. Prince, you could respond to that briefly?

MR. PRINCE: Well, I think you've -- you've stated it quite well. In hindsight it's very hard to see how these structured products could have been accepted in the way they were accepted.

I think that on a going-forward basis, if I can say so, the Commission needs to think about the next issue. In other words, it's very unlikely that structured products are going to be a problem for anyone in our lifetimes. Those are not likely to be accepted in the same way.

COMMISSIONER GEORGIOU: Thankfully.

MR. PRINCE: And the question really is, how could an industry, how could the control processes for an industry have missed something so universally, and how do you protect the next one.

And I don't know what the answer is to that, I don't know whether the next one will be sovereign debt or I don't know the answer to that but there -- there, hopefully, a part of the Commission's effort will be to try to examine why and how people as smart and with as much experience as a Tom Maheras and a David Bushnell and the rating agencies and our various regulators, how all of them could have had what turned out to be a false belief about these instruments.

COMMISSIONER GEORGIOU: Thank you. Mr. Rubin?

VICE CHAIRMAN THOMAS: Would you yield, just briefly?

COMMISSIONER GEORGIOU: Certainly.

VICE CHAIRMAN THOMAS: In terms of your comment about being accepted -- and it's on my time -- about your belief as you made with these products was accepted, my assumption is that wasn't meant in the context of something being offered and then something being accepted. You were surprised that people bought them in terms of the accepted aspect or that they were accepted as a product that would be worthwhile. Because obviously, you can't accept it unless it's offered.

MR. PRINCE: I -- I was referring to the latter in the question.

VICE CHAIRMAN THOMAS: Okay. Thank you.

MR. PRINCE: Yes.

COMMISSIONER GEORGIOU: Thank you. Mr. Rubin?

MR. RUBIN: Commissioner, I -- I would respond to that very thoughtful question the following way: I've been involved with financial markets for about 40-some years, and I can remember when the Black and Scholes models first came into prominence as a way of measuring option volatility.

And we actually hired Fisher Black, who, had he lived, would have won a Nobel prize because his co-developers of that did, and had long conversations with Fisher about how do you think about models.

And the problem with all models, and it's one reason I make the suggestion I do with respect to leverage constraints, is that they're no better than the information that you feed into them.

And in this case, the information that was fed into them and is one reason why Commissioner Born is right about derivative regulation, though I would add, margin capital requirements to be substantially increased as part, the information that's fed into them is usually 10 or 20 years of history, whatever it may be and in this instance, and I think it was the great lesson of this crisis is that the downside of the financial markets turned out not to be reflected in the experience of the last 10, 20, 30, or even

40 years, but rather to be far greater than that and far greater than anybody had thought.

And I think the one thing that could have made an enormous difference here is if there had been a recognition, although there was virtually no recognition of this, very much including by myself, that the real potential downside of our system under stress conditions was not reflected in the experience of the last some decades, but rather it was far worse.

And I think as you all go forward it seems to me that what we need to do, in both the private sector and the public sector, is to have changes and reforms that reflect what is now a new understanding of the downside risk of our system.

COMMISSIONER GEORGIOU: Okay. But -- and let me try to keep the focus on you folks, for just a minute here, because, you know, some people saw this, and I'm not saying that you needed to be as prescient as they were but, you know, there's a famous December of `06 meeting that David Viniar, the CFO of Goldman Sachs, called when they had lost money for 10 days in a row.

They had apparently a trigger, which you may know about, when you lose money in a particular trade for 10 days in a row, you at least call a meeting. And they did, and they analyzed this, and they basically shifted their position to sort of offload some of their exposure to the mortgage markets.

And of course, people like Paulson, you know, made 15 billion dollars betting against the subprime market on the hedge fund side. But you folks -- but Mr. Rubin, I'm trying to focus on you, you had a whole history at Goldman Sachs and yet careening into `07, if you will, Citi made a number of other bets that seems to me to have been, in retrospect, further putting you in jeopardy in this regard.

I mean, you bought the Argent, the Ameriquest platform from Roland Arnall in February of `07, and -- and -- and we're continuing essentially to advance your exposure in this regard.

And let me just point out one other: In July of `07, you actually started to buy back in exercise, having to exercise these liquidity puts to bring the CDOs back onto your balance sheet where they had been off-balance-sheet, and both of you testified that it wasn't until something like October of `07 that it came to your attention.

Well, that seems awfully late. And maybe had you been in a position to know earlier, you might have taken some ameliorative action to protect the balance sheet of Citi in the meantime.

So, Mr. Rubin, could you respond to that?

MR. RUBIN: Yeah, let me respond to that, if I may.

You are correct, Commissioner. There were some people. There were some hedge fund managers. Paulson was one. I think there actually are some others who really did see this complete picture. I can't speak to what David Viniar saw or didn't see, but I don't think that any major firm really saw -- and if you look at the various activities that are engaged in the LBL area as well as in these areas, I think it bears this out, really saw the potential for the kind of crisis that we had.

In terms of the purchase back at the puts, I mean, at that point I wasn't aware of it and I think I testified, I know I said this in my statement, I wasn't aware of this 43-billion-dollar exposure until I think it was September or thereabouts. So that was activity that was taking place within the business at a level that you just wouldn't see if you were on a board.

And those put -- those positions were taken back pursuant to the puts because the market had basically, at least is my understanding, had basically frozen.

COMMISSIONER GEORGIOU: Well, you couldn't sell them. I mean that --

MR. RUBIN: Yeah, they had no choice.

COMMISSIONER GEORGIOU: They couldn't sell them so you took the puts back.

But -- but wouldn't that -- wasn't that a signal to somebody? Shouldn't that have been a signal to somebody that your exposure was dramatically increasing by having to take these back?

MR. RUBIN: Well, let me just, if I may.

COMMISSIONER GEORGIOU: Right.

MR. RUBIN: You're correct. They -- they were -- they, at least as I understand it, though I wasn't aware of it at the time, they had to buy back those tranches because the markets had fundamentally become frozen.

COMMISSIONER GEORGIOU: Right.

MR. RUBIN: But still --

COMMISSIONER GEORGIOU: But that's -- this is way earlier, you know, this is almost a year; it's more than a year before Lehman fails; it's nine months before Bear Stearns fails.

MR. RUBIN: It was -- it was, as I remember correctly, what you said, July of '07.

COMMISSIONER GEORGIOU: July of `07.

MR. RUBIN: July, `07, about three months before we became aware of these Triple-A positions.

COMMISSIONER GEORGIOU: Right.

MR. RUBIN: But they still believed, as I understand it, and I think in good faith, as did the universe in general, almost, with some very few exceptions, as you correctly say, that these were Triple-A securities, that the risks were de minimus, and that this market would clarify in time, and they would begin to function again.

COMMISSIONER GEORGIOU: Right. Okay. Well, yesterday we heard from -- from -- well, let me -- let me -- let me actually ask you about one other question.

I recall, if my memory serves, that you had to either miss your Thanksgiving dinner or get up from your Thanksgiving dinner in November of `07, to fly to Abu Dhabi to raise seven and a half billion dollars in capital from the Abu Dhabi investment authority. And I guess I -- I mean, obviously you needed that capital at that time.

Would it have been possible for you to have raised more capital for Citi, either then or prior to then, that might have avoided the taxpayers having to bail out Citi at the time?

Now, I recognize it was expensive capital. It was, I get points plus 11 percent. It was really a hard money loan in certain characterizations, but could you speak to the capital requirements?

Because Dr. Greenspan yesterday said that one of the things that he would now recommend, even though he basically didn't take much responsibility for this, but he did suggest that on a go-forward basis, there ought to be a whole lot more capital and a whole lot more liquidity required of these large financial institutions in order to avoid the risk that the taxpayers will have to bail them out in the future.

MR. RUBIN: And as you know from my statement, I agree with Dr. Greenspan's positions.

COMMISSIONER GEORGIOU: Right.

MR. RUBIN: I think the average constraint should be very substantially increased, which means you would have more capital in these organizations.

My recollection, Commissioner, is that at that time, which was shortly after our new CDO -- no, that was, I'm sorry, that was when I was chairman, which is we were in the search process, one thing or another, that was we tried to raise -- I think I'm right in this, but you better ask others to confirm this -- but my recollection is that we raised as much capital as we could in that period of time.

COMMISSIONER GEORGIOU: Right.

MR. RUBIN: I don't think that there was the opportunity to raise more capital. Although, as I say, there are others who will remember that better than I.

COMMISSIONER GEORGIOU: Right. The --

MR. RUBIN: We have, because your point is extremely well taken. From that point forward, we had a highly proactive focus on raising private capital and ultimately raised some numbers of tens of billions, I don't remember the exact amount, through this period of difficulty for Citi.

COMMISSIONER GEORGIOU: Right. But of course, by that time the capital was harder to raise and more expensive to raise, right?

MR. RUBIN: Yeah. But I don't think we ever, and again, there are others, Commissioner, who have a better recollection of this than I do, but I don't think we ever held back from raising capital at that point because of price, at least not as far as I can recollect.

COMMISSIONER GEORGIOU: Mr. Prince, yes, if I could, please. Yeah, thank you.

Mr. Prince, from `06 to `07, this is referring back to the dance metaphor there. Citi increased its leveraged loan exposure limit from 35 billion to 100 billion.

If you were at all concerned about this business, how come you allowed the limits to be tripled during that period?

MR. PRINCE: Leveraged lending, Commissioner, is a business of lending money to private equity firms and so forth for them to conduct their activities.

It was widely reported in the press at the time that the private equity firms were driving very hard bargains with the banks. They were insisting on no mat clauses and payment in kind interest and so forth and so on.

My belief then and my belief now is that one firm in this business cannot unilaterally withdraw from the business and maintain its ability to conduct business in the future.

Running a securities business is a lot like running a baseball team where none of the players have contracts, and people can leave any day and go to another team.

And if you are not engaged in business, people leave the institution. And so it's impossible, in my view, in the leveraged lending business, for you to say to your bankers, we're just not going to participate in the business for the next year or so until things become a little more rational. 0you can't do that and expect that you'll have any people left to conduct business in the future.

COMMISSIONER GEORGIOU: Okay. I think if I -- if I could, just one more minute.

The -- there are several issues. It seems to me that if we -- I'm going to ask, and if we don't get a chance to answer them, I would ask you to try to respond in writing too, because there's been a lot of discussion about a whole variety of forms of arbitrage, which were engaged in by the principal financial institutions that are coming before us.

Regulatory arbitrage, to the extent that smart lawyers try to structure things in a way to -- to yield the least restrictive regulatory process.

Capital arbitrage, very important in that people move things off-balance-sheet so that you don't have to hold capital against them or you hold them in your trading desk where one of the Fed employees that we interviewed said that if you hold the trading assets, the capital requirements are so low on those that you're basically holding 750 or 800 to 1 leverage on them.

So there's a lot of different ways that very smart people who work for these institutions are able to avoid what, it seems to me, was one of the glaring failures of our system in that insufficient capital, insufficient money, was being put where their mouth was by these institutions and being held to cushion yourselves against the risk.

Could you speak briefly to that? I know we don't have a lot of time, but, Mr. Prince?

MR. PRINCE: I think, Commissioner, with respect that question is important enough and detailed enough that I would prefer to respond --

COMMISSIONER GEORGIOU: That would be -- that would be fine.

MR. PRINCE: -- supplementally.

COMMISSIONER GEORGIOU: Mr. Rubin?

MR. RUBIN: Yeah, I'd -- I agree with Chuck that a written response would be appropriate. I would make one general comment, if I may.

COMMISSIONER GEORGIOU: Sure.

MR. RUBIN: I think one of the challenges of those, who are engaged in this financial reform effort are faced, is the very technical -- the technicality of the problem.

And I think that the kinds of loopholes, loopholes may be the wrong word, the kinds of issues that you've identified do need to be addressed in terms of increasing constraints on leverage. And I think that should hopefully will be part of this process.

COMMISSIONER GEORGIOU: Right.

MR. RUBIN: But however you do it, I've been around this for a long time, but however you do it, there will always be people seeking to find ways around that.

COMMISSIONER GEORGIOU: Well, there's no question about that.

MR. RUBIN: I think this will always be a work in process.

COMMISSIONER GEORGIOU: Right. But there could be some things done.

MR. RUBIN: I agree.

COMMISSIONER GEORGIOU: And, you know, one thought is maybe there should be a principle of the total amount of capital required for a pool of assets should be the same after a securitization as before, you know, that you ought not to be able to transfer assets off-balance-sheet and end up with a circumstance where you don't have to hold any capital against them, particularly in circumstances where they may have to come back.

And, you know, it's been pointed out to me that 50 percent of the mortgages that you held were off-balance-sheet in 2007 and 58 percent in 2008.

Now, I know there's some new cap -- new balance sheet requirements that have come in as of 1/1 of '10 that may require you to bring some of them back on, but there's a reason why you had over a trillion dollars of assets off balance sheets. Somebody believed that it was in the interest for the organization in some capacity, I don't know what capacity, less capital, less visibility, who knows, but you moved a lot of assets off-balance-sheet, and so did a lot of other people; you're not alone in this regard. And it seems to me that for transparency and clarity, that needs to be addressed.

MR. RUBIN: Can I make a one-second response?

CHAIRMAN ANGELIDES: Sure, very quickly, because we have to move on.

MR. RUBIN: I'll just take one second. You've identified a very important problem. On the other hand, it's -- it's that securitization, as long as it's done under sound basis, that is very central to the functioning of our economic systems.

It seems to me that you're exactly right except that you've got to find some way to enable institutions to engage in securitization that doesn't at the same time lead to problems.

COMMISSIONER GEORGIOU: Right. And one thing, I know I'm passed my time, but let me just --

CHAIRMAN ANGELIDES: Way past.

COMMISSIONER GEORGIOU: -- say one thing. One idea that has been floated about is to have you take some risk in connection with these securities. Maybe you need to hold them.

Greenspan said it yesterday, I mean, said it in his prior testimony, maybe you need to hold them and be long and align with the investors some portion of it so that your -- your diligence is appropriately incented to be sound because you know you're going to have -- thank you very much.

CHAIRMAN ANGELIDES: All right. I yield you a couple of minutes out of my time.

Just one note for the Commission members, according to our staff, this is an estimate, just an estimate, but of the 51 billion dollars in losses related to subprime exposure, 10 -- close to 11 billion dollars appear to have been in the bank and some 40-plus were in the non-bank, just for the numbers.

COMMISSIONER HOLTZ-EAKIN: All right.

CHAIRMAN ANGELIDES: Mr. Holtz-Eakin?

COMMISSIONER HOLTZ-EAKIN: Thank you, Mr. Chairman.

EXAMINATION BY COMMISSIONER HOLTZ-EAKIN

COMMISSIONER HOLTZ-EAKIN: Let me begin with apologies, first of all, that due to the vagaries of travel, I was late and missed your testimony and came in the middle of yours. And I do apologize, it was not my intention.

And that, also, because of a prior commitment, I was unable to hear the testimony yesterday of the other representatives of Citi. And so to the extent that I'm less than perfectly informed, I apologize in advance.

Mr. Rubin, I did want to pick up on something you just said, because it really did catch my attention. You said no one could have foreseen this kind of crisis. And that was a universally sort of held belief.

I think the important thing to recognize is that the question is not whether you could have foreseen the whole crisis. The question is, could you have foreseen the spark that lit the crisis, which is the poor standards in underwriting, the poor assessments of risks associated with mortgages, the inadequate hedging and capital provisioning against that. If that's done, there is no crisis.

And in light of the fact that we've had housing crisis, the savings and loan crisis, that you are familiar and many are with the activities of Fannie Mae and Freddie Mac and identified them as a risk, and that, in your experience, you've seen crises in Mexico and in Thailand and in the Far East, wouldn't there be grounds to be at least a little suspicious at some point?

MR. RUBIN: It's a good question. I didn't say that no one could have foreseen. Actually, I think some people did foresee. What I said was that very few people foresaw the full combination and clearly --

COMMISSIONER HOLTZ-EAKIN: They didn't need to; the point is they didn't need to. They just needed to see the mortgage piece.

MR. RUBIN: Well, you know, I'm not so sure about that. It seems to me that what you had, and I said it in my opening statement, was you had a large combination of forces that had come together.

I at least think, and it's interesting discussions that one could have, I think that a few of those that occurred you would have had a very different experience than we had.

I think it was an extraordinary combination of many factors that came together. And you could say, well, you could see some of these, why didn't that suggest to you that this could be a problem.

As I said in my opening statement, I actually did worry about excesses back in 2005 and 2006, and talked about it in speeches, one thing and another.

But what I didn't see and virtually nobody saw was that it wasn't really those excesses, but it was so many other factors coming together at the same time and I think it was that extraordinary combination that lead to this crisis.

And, you know, it's interesting, and I know you've been around for a long time too. As long as we've had capital markets we've had crises. And then when you look back, you always look back and you look back and you say, well, these were -- these were obvious warning signs.

But they're not obvious at the time. They're only obvious in hindsight. And I think we all -- I personally think unfortunately that market-based systems, which I believe in strongly, will have periodic down cycles, hopefully not like we've just experienced, and that's why I think this financial reform effort is so extremely important.

COMMISSIONER HOLTZ-EAKIN: In your testimony, you did talk about low rates causing markets to reach for yield. And one way to interpret that is that, you know, many people, Citi included, were increasingly borrowing at very short term and lending longer to take advantage of a very steep yield curve.

And I guess my question is, did Citi create a structure which was, in light of the way the yield curve ultimately shifted, too dependent on a steep yield curve to survive the change in rates?

MR. RUBIN: Well, I actually was referring to something slightly different, but it certainly, and I'm not sure I totally understand the question, but it's certainly true that across the financial world, not just in this country, but around the globe, there was a so-called carry trade, which is what you're referring to, I think.

COMMISSIONER HOLTZ-EAKIN: Well, in particular, just your off-balance-sheet activities, funding things at very short maturities and at the very low rates there to make money at the -- at the longer maturities and reach yield. Is that something that across Citi became too much of the business model?

MR. RUBIN: Well, that's a good question that I don't know that -- I would say, in retrospect, not just at Citi, but I guess I'm just repeating myself, and I apologize, but across -- across the entire financial system, there was a dependence -- or I shouldn't say a dependence, but there was a great deal of this kind of a carry trade going on. I actually meant in my statements something slightly different though.

I was referring to this massive influx of capital from abroad that caused the bond market yields to be lower than they otherwise would have, and I think that was very centrally involved, because as you know very well because I know your background, mortgage -- mortgage yields tend to be a function of the tenure, and that's really what my reference was to.

COMMISSIONER HOLTZ-EAKIN: One of the risks that you're exposed to, then, is interest rate risks. And so I think the question becomes risk management.

And, Mr. Prince, you said, very clearly, you cannot overstate the need for a risk assessment in running your business. And, as I understand it, one of your capacities was managerial advice and this strikes me as central to both of your portfolios.

And I just want to review some of the things that at least the preparation of this hearing reveals, which is that on March 29, 2004, OCC examiners concluded an examination of fixed-income derivatives business at Citibank, which included the business group working on CDOs, and included that, quote, the quality of risk management is less than satisfactory. And that report was transmitted to

Citibanks -- some six banks -- six months later.

The OCC also concluded that certain CDO tranches super senior positions continue to pose risk management challenges.

Obviously, Citi had the chance to respond to that, but as we've heard, you seem to place a lot of reliance on credit rating agencies in assessing the risk associated with those senior CDO positions.

How much reliance was placed on the rating agencies from each of you?

MR. PRINCE: Well, Commissioner, with respect, the -- the positions that are involved weren't known to me, and I think to Bob, until September, October -- so -- of `07, so --

COMMISSIONER HOLTZ-EAKIN: So you don't know how much the rating agencies placed as the risk?

MR. PRINCE: So you asked how much did we place from the rating agencies?

COMMISSIONER HOLTZ-EAKIN: How much did Citi?

MR. PRINCE: Okay. I apologize. I misunderstood the question. I don't know the answer to that. David was here yesterday, David Bushnell, and I think he would have been the proper one to answer that question.

COMMISSIONER HOLTZ-EAKIN: Mr. Rubin?

MR. RUBIN: Yeah, I'll -- I'll identify with something that Chuck said and then I'll just add one comment, if I may.

Both of us learned about -- well, I'll speak for myself, but I think it was also true of Chuck -- learned about this in the fall of `07, and clearly -- and I remember that initial -- when I initially heard about it, and I had a reaction, which is in my statement, you'll see it there, to the effect that if you're engaged in an arbitrage kind of a business, and admittedly I had an arbitrage background and it probably caused me to think this way, then the other side of that transaction is to completely dispose of the risk.

But the people who were running the businesses replied, and I think their reply was totally understandable, that these were Triple-A securities and had de minimus risk and that certainly was how Triple-A securities had always been seen in all the time that I've been in the business.

So I would say from their response that they were very much relying on those Triple-A ratings. Though I also understand, and I don't recollect where I know this from, but that David Bushnell's people did an enormous amount of independent analysis, as well. And I believe that's where I saw the number, now that I think about it, that they had calculated that it was something like a 1 in 10,000 probability of a default on these instruments.

COMMISSIONER HOLTZ-EAKIN: So you're both comfortable, it's fair to say, that Citi had adequate supplemental internal risk assessment to --

MR. PRINCE: Had what? I'm sorry.

COMMISSIONER HOLTZ-EAKIN: Adequate supplemental risk assessment internally on top of the credit rating agencies?

MR. RUBIN: Well, I think you need to go back to David Bushnell was here yesterday but -- and I was -- I didn't hear --

COMMISSIONER HOLTZ-EAKIN: You were his superiors. Were you satisfied with the risk assessment in your organization?

MR. RUBIN: I think David, who I knew reasonably well, was very knowledgeable and very capable. And my impression was that they did a --

COMMISSIONER HOLTZ-EAKIN: Is that a yes?

MR. RUBIN: -- a very good -- that is -- that is a yes.

COMMISSIONER HOLTZ-EAKIN: Mr. Prince?

MR. PRINCE: I had great confidence in David Bushnell before this and I have great confidence in him now. I would trust his judgment on how this should best have been run.

COMMISSIONER HOLTZ-EAKIN: So you felt that both that the internal processes, while you weren't aware of the details of the assessment of the risk, the internal processes surfaced things appropriately?

MR. PRINCE: Correct.

COMMISSIONER HOLTZ-EAKIN: In the OCC's examination report for Citibank that ended the year September 31st, 2007, has stated that traditionally the board has been provided limited information on the material risks impacting this legal entity. And consequently they have been unable to become quite familiar with the risk assumed within the bank.

In light of that assessment by a key regulator, are you still happy with the fact that the company is proud of its -- this is your response, the company is proud of its board processes, both at the parent level and the bank level. Do you still feel that there is a reasonable basis for Citibank to be proud of those processes prior to 2008?

MR. PRINCE: I'm sorry, Commissioner, what's the date of that report?

VICE CHAIRMAN THOMAS: Prior to the answer, I yield the gentlemen an additional five minutes.

COMMISSIONER HOLTZ-EAKIN: Thank you.

MR. PRINCE: I'm sorry, Commissioner, what's the date of that report?

COMMISSIONER HOLTZ-EAKIN: That report is December 31st, 2007, for the year ending in 2007.

MR. PRINCE: Well, that was after I left, so I haven't seen that, and I haven't seen the company's response to it, but I think it's -- I think it's worth noting that the regulators, including the Fed, who are involved in the company throughout this entire period, the Fed saw everything that went to the board of directors at every meeting, and if they felt that the processes relating to the board were inadequate, it probably would have been useful for them to raise it at an earlier point in time.

COMMISSIONER HOLTZ-EAKIN: Mr. Rubin?

MR. RUBIN: I think that, and I'm repeating what I said earlier, that David Bushnell was extremely well qualified for his job. And I -- I don't have any doubt that they acted in good faith in deciding what needed to be brought to the board. And I think that they had good processes.

I think that after the fact -- well, let me add one more thing, if I may, Commissioner, because I think it's important. I think in terms of the facts at the time that those positions were taken, that they were evaluating them and making the decision to retain them rather than dispose of them, they sought Triple-A securities and sought de minimus risks.

Obviously, in retrospect, after the enormous developments that took place and the tremendous costs that they -- that those developments led to, these securities had a very different look. But I think that in evaluating whether they did what they needed to do, in terms of bringing issues to the board's attention, you have to evaluate them in terms of the facts at the time and what was reasonable for them to do at the time. And my judgment would be that they acted in good faith and did what they felt was appropriate.

COMMISSIONER HOLTZ-EAKIN: The Fed, at the same time, this is the report of the senior supervisors' meeting, which had participants from the Federal Reserve Bank, the Federal Reserve Board, the Office of the Comptroller of the Currency, the SEC, the UKs FSA, and the Japan's FSA felt that poor communication across all business lines decentralized nature of the firm created silos, that senior management did not fully appreciate the market risk of the leveraged loan pipeline or of the retained super senior CDO positions, and that management found that the balance sheet in risk loans were not adequately enforced. And traditional risk metrics for leveraged loans to CDOs did not fully represent risks.

So in both the measurement of risk and the conveyance of risks, the same regulators who you place such strength in, found that the activities appeared to be inadequate. Are you still satisfied with both the metrics used to assess risk and the conveyance of the --

MR. RUBIN: That report you just read, Commissioner, is dated when?

COMMISSIONER HOLTZ-EAKIN: This is dated November 19th, 2007.

Speaking simultaneously

CHAIRMAN ANGELIDES: And can I just add, because Mr. Holtz-Eakin was flying in, I did reference it earlier, just so you know, this is the November 19th meeting, which Mr. Rubin attended; part of the meeting Mr. Bushnell was there. This is the one I referred to earlier.

COMMISSIONER HOLTZ-EAKIN: Thank you.

MR. RUBIN: I think the -- I think the problem with a report like that, Mr. Commissioner, is that you have to distinguish -- it's actually a very important point, so I would like to spend a moment on it, if I may.

COMMISSIONER HOLTZ-EAKIN: Please.

MR. RUBIN: I spent a career evaluating trading operations at Goldman Sachs when I was running it or co-running it and so forth. And the challenge always was to try to figure out whether people had acted reasonably and sensibly in light of the facts that they knew at the time as opposed to when you look back at them after you knew what had happened.

And I think the report you need to read is not the one you just read, because at that point they knew what had happened. I think what you've got to do is find the reports that they issued before that, before they knew what was happening, so that you would know what they felt --

COMMISSIONER HOLTZ-EAKIN: Please, continue. My apologies.

MR. RUBIN: Excuse me?

COMMISSIONER HOLTZ-EAKIN: Please continue. Our apologies.

VICE CHAIRMAN THOMAS: I apologize.

MR. RUBIN: I'm -- I'm a little -- all right.

COMMISSIONER HOLTZ-EAKIN: Go ahead. You did nothing wrong; we did.

MR. RUBIN: So I think what one needs to do is look back at the reports that were issued before the crisis developed. And then if there were problems, and I don't know if those reports stated these sorts of problems or not, but if there were problems, I presume the regulators would have brought them to the attention of the company, and the company would have addressed them.

It is very -- and I can tell you from my own experience, because I lived this for years, it is very, very difficult after the fact to try to make a judgment as to what was reasonable at the time because you get so influenced by knowing what had happened.

COMMISSIONER HOLTZ-EAKIN: It's a fair point. Are you aware of any reports from supervisors prior to the crisis, 2004, 2005, 2006, which suggests this same characterization of Citibank's internal risk assessment and communication of risk?

MR. RUBIN: If there -- if there were such reports, Commissioner, I'm not aware of them. And if there were such reports, I assume that the company would have addressed to them -- addressed them in response to those reports and that the regulators would have insisted they be addressed.

COMMISSIONER HOLTZ-EAKIN: Well, if there were such reports, they're still writing the same thing later. So we can pursue the existence of the reports, and I'd ask the liberty to come back to you with additional questions on that front.

MR. RUBIN: Thank you.

COMMISSIONER HOLTZ-EAKIN: Thank you. I yield back my time.

CHAIRMAN ANGELIDES: Yes. And I just might add, Mr. Holtz-Eakin, and I think you did point out, I just want to point out that Mr. Holtz-Eakin did reference reports that were pre-crisis, very specifically. And I think you referenced the `04 and the `05 reports that are very clear on this subject. So I -- we will -- we will direct the

Commission staff to provide that information to you.

I also just want to correct something, for the record. When I asked the question to the staff of on balance sheet, off-balance-sheet losses, it was -- there was a miscommunication. So the 10 billion and 40 billion dollar number do not use, folks. We will get you the right number. Except I will say that the losses in the non-bank were very substantial.

All right, let's go now to Ms. Born and then we'll go to Mr. Thompson.

COMMISSIONER BORN: Thank you very much, Mr. Chair.

EXAMINATION BY COMMISSIONER BORN

COMMISSIONER BORN: And I also want to sincerely thank both Mr. Prince and Mr. Rubin for being willing to appear before us today and help us with this important inquiry.

Mr. Rubin, you said in your book, several years before the financial crisis erupted that unregulated OTC derivatives can cause problems, in your view, when the markets become stressed.

Do you believe that they did, in fact, contribute to the financial crisis?

MR. RUBIN: I believe that the -- at the very least, the credit default swaps seemed to have played a role in the financial -- and maybe even a meaningful role in the financial crisis. Whether any derivatives beyond that did or not, I do not know, Commissioner.

My reference, by the way, in the book, which I appreciate that you obviously read, is -- was derivatives more broadly, not just over-the-counter derivatives.

COMMISSIONER BORN: Do you now think that there's a need for any regulation of the OTC derivatives market?

MR. RUBIN: I think that there should be, and I thought this when I was at Goldman Sachs. I think that there should be regulations of over-the-counter derivatives, but I also think that the regulation of listed derivatives should be enhanced, particularly through increased capital and margin requirements.

COMMISSIONER BORN: You say in your testimony that you feel that standardized derivatives should be exchange-traded and that customized contracts should be at least cleared, if possible, and if not, there should be disclosure of information about them. Could you elaborate on what benefits you think that would provide?

MR. RUBIN: At the very least -- well, if you standardize them, to the extent that you can get, and I know you're an expert in this field, Commissioner, but to the extent that you can standardize these instruments, not only do you have disclosure and transparency to the regulators and to the markets, but you also have potentials for netting within organizations that I think could considerably reduce the risk in times of stress.

The over-the-counter derivatives obviously present a more difficult problem, but it does seem to me, and I understand that technically this is very difficult, but it does seem to me that if it is possible to put these over-the-counter derivatives through a clearing system, you then go with reduced counterparty risks and you increase transparency.

If that is technically not possible, and I understand there are a lot of technical problems, then it seems to me at the very least, there ought to be some means found for creating transparencies so that the regulators at the very least, I'm not sure what I think about the markets, but the regulators at the very least know what the exposures are.

COMMISSIONER BORN: You said in the past that there was no political will to regulate over-the-counter derivatives.

Do you -- in your view was the lack of political will related to pressure by the financial services industry?

MR. RUBIN: In the -- I think they were very strongly held views in the financial services industry in opposition to regulation. And I think that they were not overcomable, it's probably not a word, overcomable, but not surmountable at that point.

Can I just do one brief anecdote? When I was at Goldman Sachs, in my last year or two, my co-partner, senior partner and I, felt a very serious concern about this, and I went to see Dick Fisher, who at that time was the senior partner at Morgan Stanley and really a distinguished leader of our industry, and he agreed.

And so I started an effort to see if we could do something. And our focus then was on margin requirements, Commissioner. It didn't have the breadth of the later proposals.

And it very quickly became apparent that there was simply no possibility of moving forward. And that was for the very reason you said, and that is, the industry had very strong views on this and it wasn't going to be something that we could do.

COMMISSIONER BORN: Do you think that the lack of political will may also have been affected by a pervasive view that the market was appropriately self-regulatory and that there wasn't a need for regulation?

MR. RUBIN: I don't -- that's a level of sophistication, it's a terrifically interesting and important question, but I don't think when you got into the political arena that that really was what this was about. I think this was more about the interests of those who were involved and their ability to effect those interests, effect, e-f-f, yeah, effect those interests, rather than the much more sophisticated question that you're raising.

COMMISSIONER BORN: You said that you think that at the least credit default swaps played a role in the financial crisis.

Looking at the bigger over-the-counter derivatives market, there is a lot of inner-connectivity that's created through the contracts. There's also a lack of transparency. And I wonder whether or not those problems plus the lack of effective price discovery played a role in some of the financial panic that struck in 2007 and 2008.

MR. RUBIN: Oh, listen, that point is extremely well taken, and it's too big to fail idea, but the other area is too interconnected to fail. And that's precisely the point that you're raising. So I think the answer to your question is yes.

COMMISSIONER BORN: Do you think that your proposals for exchange-trading, if possible, clearing, if possible, disclosure of information, at least to the regulators, would address some of that problem?

MR. RUBIN: In part, Commissioner, but I felt back when I was at Goldman Sachs and I felt ever since and I still feel now that you do need one more piece. And I do think that you need substantially increased capital to margin requirements because that will give you greater cushion in the event that problems occur.

And I think I said in my book, as long as you have normal conditions, I don't think any of this is particularly a problem. But the trouble is under stress conditions, you can get very serious issues very quickly. And so I think you need a bigger cushion.

COMMISSIONER BORN: In that connection, you know, there are margin requirements on exchanges. They can be raised and probably should be raised. The -- in the over-the-counter derivatives market, the instruments themselves have lent themselves to high levels of leverage.

There are a number of instruments which have seemingly been designed just to build in a great deal of leverage. And there aren't currently any mechanisms to require margin or collateral on that; is that correct?

MR. RUBIN: Yes, that is correct.

COMMISSIONER BORN: Do you think -- I'm concerned that some of the complexity that's entered into the market, some of the highly complex instruments may not really be fully understood by the parties, either by the over-the-counter derivatives dealers themselves, their management and board, boards, or by the entities that are purchasing them.

And I think particularly of the problems we've heard in municipalities, like Jefferson County, Alabama, the grease problems that were evidently somewhat designed to disguise the amount of greases, exposures, and debt, I would like your views on the need for this degree of complexity. I'm not sure regulators have the capability of understanding these instruments. I don't know if anybody else does fully.

MR. RUBIN: Oh, it's a very good question, Commissioner. And I think I -- my recollection is I did discuss this in my book. I may be wrong about that recollection, but I think I did.

I think the complexity -- I think the complexity is understandable and actually useful -- well, not complexity, per se, is never useful, I suppose -- but is a product of the purposes that are trying to be accomplished.

On the other hand, I think your point is correct, and I lived this for a long time, so I actually knew a fair amount about it. I think your point is correct that I think users of these instruments very often don't understand that the complexities and the risks embedded in them, not under normal circumstances, but under stress conditions.

And that's exactly why I think, or it's one reason why I think, capital margin requirements could be greatly increased. Number one, at least you would have greater cushion. And I also think that if you have greater capital margin requirements, it would cause people to focus more on trying to understand the risks they were taking and probably result in less use of these instruments. And I think on balance, that would be a desirable outcome.

COMMISSIONER BORN: Thank you.

CHAIRMAN ANGELIDES: Okay, fine. Mr. Thompson?

COMMISSIONER THOMPSON: Yes?

CHAIRMAN ANGELIDES: Ms. Murren, do you have a question, before I go to Mr. Thompson, on this point?

COMMISSIONER MURREN: Just a follow-up on your comment about your perspective that you think capital --

VICE CHAIRMAN THOMAS: I yield the Commissioner two minutes.

CHAIRMAN ANGELIDES: Fine.

COMMISSIONER MURREN: It will be short.

EXAMINATION BY COMMISSIONER MURREN

COMMISSIONER MURREN: You mentioned capital requirements are very important. Did Citigroup ever create products that were specifically designed to avoid capital requirements?

MR. RUBIN: I don't know the answer to that.

COMMISSIONER MURREN: And you, Mr. Prince, would you create a product simply to -- or at least one of the principal reasons for designing the product was to avoid capital requirements?

MR. PRINCE: I -- I think the answer is no because the product would have to be designed as something that a client would want. In other words, you wouldn't -- you wouldn't create a product that was internally focused.

If your question is, would the -- would the team create products -- and in the course of creating the products, try to minimize capital burdens, my guess is the answer is yes, but I don't know for sure.

COMMISSIONER MURREN: So then it wouldn't surprise you to know that in the minutes of one of your meetings that specifically relate to the creation of new products, in this instance, it would be liquidity puts, that there was a notation that specifically referenced the fact that this type of structure would avoid capital requirements?

MR. PRINCE: I have no way of responding without seeing the document and understanding the context of it.

CHAIRMAN ANGELIDES: We will -- we will provide the document. What is the document, so we can reference it, Ms. Murren?

COMMISSIONER MURREN: It's the minutes of a meeting that took place in 2002 of a CMAC.

CHAIRMAN ANGELIDES: CMAP, which is the committee that approved new products for your institution, correct?

COMMISSIONER MURREN: Yes.

CHAIRMAN ANGELIDES: All right. We'll provide that document so you can review it, and if the staff would make sure we follow up.

COMMISSIONER MURREN: Thank you.

CHAIRMAN ANGELIDES: Can we go -- let's go do this. Mr. Thompson -- is it --

COMMISSIONER WALLISON: Can you --

CHAIRMAN ANGELIDES: Absolutely, Mr. Wallison.

COMMISSIONER THOMPSON: Thank you, Mr. Chairman.

EXAMINATION BY COMMISSIONER THOMPSON

COMMISSIONER THOMPSON: The topic you're on is actually something that is important to me and it's all around financial innovation.

And, Mr. Rubin, you've had a long, long career in both the private sector and the public sector. You've seen innovation in this industry for a long time, and you understand the public policy role for making sure that we protect the public's interest when there are innovations that hit a marketplace regardless of industry.

So I guess my question of you is, what steps should be taken to ensure that products that have a societal effect, like some of the structured products that were brought to market by this industry, are well tested before they get there, before we create in the process another calamity like the one we're experiencing?

MR. RUBIN: That's an interesting question. I think that probably as desirable as it would be to accomplish the purpose that you just outlined, that may not be doable because the problem is -- well, let me put it differently -- when problems develop with these kinds of instruments, it's usually because of some set of circumstances that hadn't been anticipated.

So what you can do internally and what all of the institutions do is they test their instruments against, I think I said this before actually, some past history of 10 years or 20 years or whatever it may be, and they look at what was the worst reasonable case, and then they make a judgment, okay, what are the risks of loss, and it's one thing or another.

And then what happens when you have very great difficulty is something else happens, something you didn't anticipate. And because of that problem -- that's actually a very good question. Because of that problem, it seems to me that the answer comes back to where I was before.

I think you've got to create a system that can deal with the unanticipatable or at least unanticipated.

And that's why I think leverage constraints have to be substantially increased and why I would increase margin capital requirements on all these innovative products.

I might add, and I think this is important, well, I'd like might add one more thing if I may. I think financial innovation actually does play an important role in our economy and a constructive role. I just think you need an appropriate, if you will, regulatory framework for it.

COMMISSIONER THOMPSON: Well, some would argue that financial innovation is nothing more than regulatory arbitrage of one sort or another. Would you agree or not with that?

MR. RUBIN: No. I actually don't think so. I think an awful lot of innovation has nothing to do with regulatory arbitrage.

I remember a case of a country, for example, that had a very large exposure in the oil business, and they basically needed -- well, they didn't need, but they decided they wanted some way to hedge themselves against future oil price movement so they continued to fund their social programs. Nothing to do with regulatory arbitrage, but they did need to create an innovative structure to do that, and I think we should have a system that allows us to do that, but on the other hand, I think we have to recognize that there is systemic risk that can be created in doing that, and that's why we need the kind of framework that Commissioner Born and I were discussing a bit ago.

COMMISSIONER THOMPSON: Mr. Prince, can the risk management systems of an organization like Citi keep up with the rate and pace of innovation that goes on within the organization of Citi?

MR. PRINCE: Well, that's a -- that's a very important question. I think that the risk function we had at Citi was extremely robust. As I said, David was thought of as the best risk manager on Wall Street.

We had a couple thousand people in the risk organization independent of the businesses able to say no any time they wanted to. The businesses operated under the constraints, risk limits and so forth.

A different question, and perhaps the one you're getting to, is whether or not the intellectual capacity, the -- the -- the smartness of the people can keep up with the innovation of the traders and so forth. I think that the key there, and what I took very seriously as my job, was to make sure we had the best people involved.

When I became CEO, the first thing I did was to put David in charge, because he understood the securities business. He had been a trader in his past life. I made the risk function independent of the businesses. I took great comfort over the years from the frequent comments from the regulatory authorities commenting on David's strength as an individual and on the strength of the function, notwithstanding the after-the-fact document, apparently. And I think that's, in some level, the best you can do.

We never had a situation where a product went out the door that hadn't been looked at by risk. And whether, at times, they didn't do as good a job as they could have, I'm sure, human nature being what it is. But to set up a structure and to put the right people in that structure is I think the best you can do.

If I can, just one point. I think the regulatory situation ought to be changed.

COMMISSIONER THOMPSON: That's where I'm going next.

MR. PRINCE: I think all of the different regulators and the different schematics I think is crazy. And I think, to the extent your earlier question went to that, I just wanted to make sure I commented on that.

COMMISSIONER THOMPSON: Yeah, I -- I -- innovators and by their sheer nature are passionate about what they do, and so it's -- my personal opinion is it's not clear to me that a risk management function can keep up with the passion and the creativity that a very aggressive, innovative team brings to bear.

And I think that poses a systemic risk, quite frankly, to the industry, because of the pace of innovation that has occurred. But that's just my opinion, if I might add.

On the regulatory front, yesterday Mr. Bushnell said that he thought that some consolidation of the regulatory oversight was, in fact, warranted because there were way too many regulators, if you will, that they would have to deal with.

If I look at what happened in Canada or if I look at what happened in the UK, would you comment, given that you are a global bank, on the differences that you observed in the regulatory scheme of their -- and the recovery process perhaps, because all those economies were hit just like we were, but the recovery process and the rigor of their oversight versus what we have here.

MR. PRINCE: I think that's, with respect, too broad a question for me to cover in any depth. If I can, let me give you the best answer I can under the circumstances.

I think that the regulatory structures in the various jurisdictions you talked about compare with the United States in some ways more favorably.

The regulatory structure in the U.S., being historically based from the time after the Depression, has great inefficiencies in it, great overlaps, great redundancies. And I think that a more streamlined and a more efficient regulatory structure would lend itself to greater probity for the -- for the industry.

I think the way that the various economies have reacted to the crisis may be due in part to that, but I think it's also due in part to the nature of the closed or open nature of the financial services industry.

In Canada, for example, it is a more closed industry. In the U.S. and the UK, it is more open to the market of this institute in respects. So it's not just the regulatory environment.

COMMISSIONER THOMPSON: All right. Thank you very much. I yield the rest of my time, Mr. Chairman. Thank you.

CHAIRMAN ANGELIDES: Thank you, Mr. Thompson.

Now, Mr. Wallison, you had an item and then Mr. Georgiou and then we'll go to the Vice Chair, and I have just a few remaining questions. Yes, Mister --

COMMISSIONER WALLISON: Thank you very much.

EXAMINATION BY COMMISSIONER WALLISON

COMMISSIONER WALLISON: This is for Mr. Rubin.

I was -- and I could have misunderstood this, but I thought you said that when you were at Goldman Sachs, you were concerned about something in the derivatives market, and I thought it might have been credit default swaps. What was that?

MR. RUBIN: Oh, no, it wasn't, in fact, I don't think credit default swaps. To the best of my knowledge credit default swaps --

COMMISSIONER WALLISON: They were not important, then?

MR. RUBIN: Oh, no, no, they didn't exist until much, much later.

COMMISSIONER WALLISON: What was it that you went to see Mr. Fisher about?

MR. RUBIN: Oh, I was -- I'll tell you what I was concerned about. October 19th, 1987, as you remember, we had a 22 percent drop in the stock market.

COMMISSIONER WALLISON: Right.

MR. RUBIN: Some of the traders who were involved at that time said to me they thought that portfolio insurance had a real effect on that it's an issue we haven't discussed here actually it's not a credit issue; it's an ability of the lower trust or rather a potential for the derivatives to feed back into and exacerbate cash market movements.

And so what I thought was that we should have higher margin requirements on derivatives because of that potential for -- under stress conditions, for derivative to feed back into cash markets. And that was the framework for that discussion.

COMMISSIONER WALLISON: I see. Now, when you were Secretary of the Treasury, however, you -- you opposed any regulation of derivatives, so why --

MR. RUBIN: No.

COMMISSIONER WALLISON: -- did you oppose it?

MR. RUBIN: No, I -- I -- let me --

COMMISSIONER WALLISON: At least that's the story we have in the newspapers.

MR. RUBIN: I don't know.

COMMISSIONER WALLISON: So maybe you want to clear that up.

MR. RUBIN: I'm aware of that. Let me, if I could, respond.

COMMISSIONER WALLISON: Sure.

MR. RUBIN: It will take a moment or two to respond to it.

I think there really were two issues. I was not opposed to regulation of derivatives, let me say. My dues and derivatives were the dues I set out, you know, a bit ago.

But there were two issues, and Commissioner Born very rightly raised the question of risks and over-the-counter derivatives. I agreed with her view, because and as I already expressed about these risks. There was a second issue, and the second issue, which I had been advised about upon by counsel for Treasury, was that approaches within the existing regulatory framework that were being considered could create legal uncertainty in the over-the-counter market, that it could take years to resolve that in court, and that that could lead to chaotic conditions.

COMMISSIONER WALLISON: That's right.

MR. RUBIN: My concern was avoiding that legal uncertainty. I was not opposed to regulation derivatives. Quite the contrary, I was actually tried to accomplish something to that, in that regard, when I was with Goldman Sachs. And my views have not changed since then.

COMMISSIONER WALLISON: Okay.

CHAIRMAN ANGELIDES: Now, Peter, we -- go ahead.

COMMISSIONER WALLISON: Well, there's one more.

CHAIRMAN ANGELIDES: Well, we're out of time.

COMMISSIONER WALLISON: Real quick.

CHAIRMAN ANGELIDES: Can you submit it for the record? Can you say what the question is and we'll get a written response?

COMMISSIONER WALLISON: Sure, I'll submit it for the record. Thank you.

CHAIRMAN ANGELIDES: Do you want to state what it is so we can get it on the record? State it -- state it very quickly.

COMMISSIONER WALLISON: Let me just state it, you were talking about stress in the CDS market, that it becomes very dangerous when there is a lot of stress.

But my understanding is that throughout the financial crisis, even after Lehman, the CDS market has continued to function. And so I -- I just want to understand, and don't answer it now please, because we don't have the time, but I would like -- I would like you to respond in writing to the question of why it is that the CDS market was not disrupted and continued to function during this entire --

MR. RUBIN: I think it actually functioned with enormous volatility, but I'd be delighted to respond.

COMMISSIONER WALLISON: It was risk, of course.

CHAIRMAN ANGELIDES: Mr. Georgiou?

COMMISSIONER GEORGIOU: I just wanted to state something for the record. As you respond to the issue that was raised by Commissioner Murren on the capital arbitrage question with regard to the liquidity puts, you know, that -- those were to be distinguished from an unconditional line of credit that might otherwise be necessary to backstop the commercial paper that you were selling. And that, of course, you would have to show on your books and capitalize.

Whereas, the liquidity put was, you know, was off-balance-sheet and not -- not appropriately capitalized or not required to be capitalized under the rules or at a very, very significantly less margin.

I just leave you with that as you -- as you respond to that in writing. Thank you.

CHAIRMAN ANGELIDES: Mr. Thomas?

VICE CHAIRMAN THOMAS: Thank you, Mr. Chairman.

EXAMINATION BY VICE CHAIRMAN THOMAS

VICE CHAIRMAN THOMAS: I want to thank both of you. Just one specific question, again, if you want to do it in writing, what I'm a little confused in terms of talking about managing the company and stress test the rest, it's my understanding based upon the documents that we looked at that -- that Citi really didn't have the technical capacity to assess the RMBS models until `07.

So I'm wondering what was going on, prior to `07 in terms of management tests, questions being offered. So I'll give you documents and we can fit it together and you can give me a timeline.

I started out talking about the garden of good and evil, and I meant that. Because unfortunately and frustratingly, we can agree that all models, all ratings, all stress tests are useful. And then you can say all models, all ratings, all stress tests may not be useful in terms of a model you look at or a model that you don't look at.

It -- it -- it means, then, that you've got to go to some timeless kind of approaches to a certain degree. I will tell you, I wouldn't be here if the function of this Commission was to examine policy that would be offered by the Commission for Congress to create legislation to deal with this problem, because I've been down that road too many times before.

I like things that are twofers and threefers. So one of the reasons I like capital is that it does give you the cushion. But it also slows everything down because you just create -- we've seen folk, partly in the .com bubble, create synthetic capital. It's hard to create synthetic. That's why I like dividends in terms of operations of companies; you get cash on the barrel; that's good.

There's just something about -- now, if you create devices that produce that, then you're getting away from reality.

The other problem is if we talk about derivatives, sure, let's classify them as standardized and customized, and it's going to be, what, three weeks that the market comes up with a rack of B. Spoke suits that are going to fit, and they're all customized, they're not standard, and you simply shift if those are the standards.

So I said I'm glad we're not doing this but I do think the capital, a lot of transparency, and especially responsibility tied to behavior.

I will tell you, it is impossible for me to go back home, which I'm going to do shortly, and tell people that we had a panel of four people who over three to five years earned, based upon the creativity that they supervised, which apparently they didn't understand and couldn't measure, almost 150 million dollars on the way up. But that same team, on the way down, didn't have a nickel clawed back.

And I don't like government telling people what they can make, but if there isn't some attempt by this industry to equate value in some way with effect, across the corporate model, with what ordinary people perceive as value.

I can't comprehend a baseball player making a quarter of a trillion dollars over ten years. But I can tell you I can measure him. I can look at his batting average, I can look at his errors, I can look at his RBIs; there's all kinds of ways to measure.

We sat through a panel, and again, I want to thank you, because Citibank's an example. It's not pulled out for a certain extraordinary aspect except for maybe the management in your organization, because I'm interested in the national/international.

But basically, we've been given no opportunity or understanding and plenty of declaration about how we used all the tests available, and nobody knew. Yes, but something happened. Something was created, assumptions were made, and behavior has to have consequences. To say you're sorry -- and you can make your -- your stock argument, Mr. Prince, most of these guys that were in front of us yesterday got something other than that as well.

And to make the argument that somehow a simple apology still allows you to maintain a profile of income based upon what devastated everyone else doesn't fit the scale test, no matter how often you feel really, really sad about what happened. Thank you, Mr. Chairman.

EXAMINATION BY CHAIRMAN ANGELIDES

CHAIRMAN ANGELIDES: All right. Mr. Prince and Mr. Rubin, let me just make a couple of conclusive comments here having now heard a day and a half of testimony from folks within your organization. The two of you today now having read along with many commissioners very extensive documentation and interviews.

Let me preface this by saying that if I die 51 percent right and 49 percent wrong I'll be a happy man. I don't aspire to reach what Mr. Greenspan thinks he's reached, which is 70/30.

And let me also preface this by saying that I believe you're men of good faith.

But I want to bring us back to why we're here today, which is, we have been trying to examine how this substantial far-flung financial empire failed to the point where the United States government had to provide 45 billion dollars in assistance as well as 301 billion dollars in guarantees of assets.

I also want to kind of key off something Mr. Holtz-Eakin said, which is that in one particular area, subprime lending, there was a massive failure, approximately 50 billion dollars in losses.

And what I've been struck by in the documentation and in the testimony is I've been struck by, frankly, how much folks in the organization did not know about how -- what was going on, and I'm particularly struck by how much the two of you did not know about how much was -- what was going on within your organization.

And at the end of the day you were the head guys. You were the chairman and the CEO. You were the chairman of the executive committee. And not, I might add, Mr. Rubin, a garden-variety board member. You were in the suite of executive offices.

And if you look at the record, Mr. Holtz-Eakin did point out there were a number of regulatory reports on the table. Mr. Bowen, who was here yesterday, had sent information up, not, by the way, about a piddling business, but a 50-billion-dollar-a-year business in which mortgages were being bought and then sold, in which there appeared to be very substantial compliance issues.

We've discussed the fact that Citigroup had 11 billion dollars of warehouse lines out to subprime originators, which you, as management, were not aware of. Mr. Holtz-Eakin referenced the senior supervisors' report, which did catalogue a number of significant issues, and even today, I think it's clear from the record that even after HSBC had its problems, and Bear Stearns, there were -- there were not the highest level of decisions about -- about how to handle subprime. That didn't come until September and October.

And it just seems to me that at the end of the day, the two of you in charge of this organization did not seem to have a grip on what was happening.

Now, Mr. Prince, I will say that on November 4th, you took responsibility and you resigned. Mr. Rubin, I want to ask you very clearly, because you've gone out of your way, in my opinion, in the interviews I've read and in public statements, to make a very fine point or a very large point about how you are not involved in operations. You've said how you made speeches warning about potential risks.

But of course you have very direct duties. You were chairman of the executive committee of the board of directors; you attended weekly business meetings, your compensation, according at least to your own testimony, was a one-million-dollar salary plus a 14-million-dollar guaranteed bonus.

Mr. Prince, in your interview you indicated that the level of interaction between you and Mr. Rubin was frequent, that you would talk three or four times a day. If one of you was out of town, you would talk by phone every other day. Mr. Rubin, you were very involved in the investment banking business. And I guess I would ask you, Mr. Rubin, just very clearly, do you bear central responsibility for the near collapse but for the U.S. government of Citigroup?

MR. RUBIN: I think, Mr. Chairman, let me respond to that in a number of parts, if I may, okay?

CHAIRMAN ANGELIDES: Sure.

MR. RUBIN: Because I think you posed, obviously, an important question.

Number one, the executive committee of the board, which you just referred to my being chairman of, was an administrative body; it didn't have a decision. What it did was it met between board meetings. Those meetings were very infrequent. And it wasn't a substantive part of the decision making process of the institution. It was designed to deal with -- it was designed to be conveyed by the chairman, which was me, so that the COO or whoever else could get formal approval, if necessary, between board meetings. It was not a, as I say, a substantive part of the -- of the decision making process of the institution.

I think that all of us bear, but not just all of us at Citi, I think all of us, and I said this in my comment, I think all of us in the industry who failed to see the potential for this serious crisis and failed to see the function of the multiple factors at work bear responsibility. And I think we all have a great deal to the regret in that respect.

I was not involved, as you correctly say, in the management of the people or the personnel. I was a member of the board. I worked extensively with clients. My interaction on other issues was on a strategic and managerial level. And I think, as I said in my statement, that the Triple-A securities that were at the heart of this problem were understandably viewed by those who had conducted the business, were involved in the business, as being essentially of de minimus risk. And this really did not -- this did not come to us until September of `07.

CHAIRMAN ANGELIDES: But it went terribly wrong, Mr. Rubin, and even at the end, investors are being informed that you have a 13-billion-dollar exposure when, in fact, the audit risk community and the board, of which you're a member, is being told 55 billion on the same day.

And I guess -- I don't know that you can have it two ways. You either were pulling the levers or asleep at the switch. And I -- and I think this is about, as we try to recover from this calamity, I'm not so sure apologies are important as assessment of responsibility, because that's the way in which you begin to move forward.

And perhaps, instead of asking you what -- what did you know and when did you know it, maybe I should be asking you what didn't you know and why didn't you know it.

MR. RUBIN: I think that the board, of which I was a part, and me and the other activities that I was involved in had a very serious commitment to oversight and to assuring, as best we could, that the institution conducted its business appropriately.

But, Mr. Chairman, a board cannot know what is going on in the positions of an institution, of a training institution. There probably was some number, I don't know the number, but I would guess it was a trillion dollars-plus of transactions that went through Citi every day.

And what you can do and what Citi, in my judgment, absolutely did and that I was part of doing as both a member of the board and also some other activities was making sure that you have the proper people in place, running trading, running independent risk management, and the large -- and the checks and balances functions that we had, which included, obviously, our internal auditor, our legal counsel, CFO, and the rest, and you can also be sure that you have robust processes at the board level, which I don't think there's any questions that we had. We had, as I think I mentioned earlier, reports of the board at every meeting about the risks in the institution.

And you're depending on those processes, depending on having the right people in those jobs, which I think we did, and depending on those processes being robust and highly proactive, which we did.

CHAIRMAN ANGELIDES: All right, I'm going to make -- I'm going to make one last comment on this, and that is the following: You were not a garden-variety board member. You were chairman the executive committee, and you can characterize it, but to someone, I think to most people, chairman of the executive committee of the board of directors implies leadership, certainly 15 million dollars a year guaranteed implies leadership and responsibility. Mr. Rubin assumed responsibility, said it was the honorable thing, and I just think, Mr. Prince -- excuse me, Mr. Prince, when he resigned, said it was the honorable thing to do, and I just, my point is I think that leadership and responsibility matters.

MR. RUBIN: I agree with that, but if I may say so, Mr. Chairman, the executive committee is really misconstrued in that comment. The executive committee was a formal administrative apparatus; the institution had nothing to do with one's role in the function of the institution.

I did feel, in `07, because of all the problems, well, actually, it wasn't because of all the problems that had developed. I did feel in `07 that I should not get a bonus. But the reasons was not the reason that you're alluding to. The reason was I felt that in my stage of my career, one thing and another, that money could be better used by the rest of the institution, by the institution for other purpose.

So I went to the compensation committee, went to the management and suggested that I not get a bonus in `07, which I did not get, and I did exactly the same thing in `08.

CHAIRMAN ANGELIDES: Well, this is you'll be the only one in the end who can make an assessment of your responsibility. A risk business always implies that there's upside and downside. It's not about the fact that there were failures, but acknowledging and understanding are important. But that's up to you and for people to judge.

MR. RUBIN: Mr. Chairman, I totally agree with that, but I think it's also very important to understand how one of these institutions works, what roles people can play, and what they cannot possibly play. And that's why --

CHAIRMAN ANGELIDES: Well, you make your case. Mr. Vice Chair?

MR. PRINCE: Mr. Chairman, before you leave the point, before you leave the point, you didn't ask me my opinion.

VICE CHAIRMAN THOMAS: We're not leaving the point.

CHAIRMAN ANGELIDES: Oh, excuse me?

MR. PRINCE: You didn't ask me my opinion on this, but I would like to state, if I may.

CHAIRMAN ANGELIDES: On Mr. Rubin?

MR. PRINCE: That I think it is absolutely incorrect to suggest that Mr. Rubin had central responsibility or any central responsibility for what happened to Citigroup.

CHAIRMAN ANGELIDES: I appreciate you -- your acceptance of your role.

VICE CHAIRMAN THOMAS: Okay, and I appreciate that.

EXAMINATION BY VICE CHAIRMAN THOMAS

VICE CHAIRMAN THOMAS: Mr. Prince, you were CEO?

MR. PRINCE: Yes.

VICE CHAIRMAN THOMAS: And you resigned?
MR. PRINCE: Yes, sir.
VICE CHAIRMAN THOMAS: What happened at Citi, then, at Citicorp?
MR. PRINCE: I don't understand.
VICE CHAIRMAN THOMAS: After you left.
MR. PRINCE: I -- is this a rhetorical question, Mr. Vice Chairman?
VICE CHAIRMAN THOMAS: No.
MR. PRINCE: I don't understand the question.
VICE CHAIRMAN THOMAS: Who assumed the position of CEO?
MR. PRINCE: Sir Win Bischoff became the CEO --
VICE CHAIRMAN THOMAS: When?
MR. PRINCE: -- of Citigroup the day I resigned.
VICE CHAIRMAN THOMAS: Okay. And then what happened in terms of the office of CEO?
MR. PRINCE: At that point a search was conducted, and sometime thereafter Vikram Pandit became CEO.
VICE CHAIRMAN THOMAS: And there was obviously a search?
MR. PRINCE: Yes, sir.
VICE CHAIRMAN THOMAS: Mr. Rubin, as chairman of the board, notwithstanding all of the discounting, it's really hard to believe that in a time of stress, based upon

your background, your experience, your involvement, not only at Goldman Sachs, but as Secretary of the Treasury, and the role that you played getting up from your Thanksgiving dinner to -- to do the kinds of things that you obviously had to have fairly significant knowledge of in the corporation, to then back away from any kind of critical decision, I'll accept it because you've said that's the case, but it just brings into question any number of items we've been asking, which have been dismissed because you've had such an overall structure, you were so coordinated, you trusted all those people under you.

And yet, when we go back, and I understand I'm getting older, my memory isn't as good, I just made a mistake on a date, but we have the record open. In terms of written questions, you said would you respond to them, and I just want to give you a heads-up as we finish this that in our attempt to understand at least in some depth one corporate model, there are going to be additional questions trying to understand how with middle management and upper management panels and CEO and chairman of the board panels, that we're comfortable with the assurance that you know what was going on but that everybody denied any responsibility involved in it.

MR. RUBIN: Could I just make one factual correction, Mr. Vice Chairman?

VICE CHAIRMAN THOMAS: I need factual corrections, obviously.

MR. RUBIN: No, no, I wasn't -- okay -- I wasn't chairman of the board.

VICE CHAIRMAN THOMAS: You were not chairman of the board?

MR. RUBIN: I only became chairman of the board after Mr. Prince stepped down. I remained chairman of the board for the four or five weeks of the search process. And the search process then resulted in Vikram Pandit being selected.

VICE CHAIRMAN THOMAS: Why would they make you chairman of the board if you had no knowledge of the structure, the information, the operation of the company in any meaningful way, was what I got out of your --

MR. RUBIN: I had a lot of understanding of the structure and function of the company.

VICE CHAIRMAN THOMAS: Right. And when you're looking for a CEO, you're going to look for somebody who hopefully has and understands the knowledge of some of the problems. We don't need to carry this out. All I'm saying is I've got this problem with --

MR. RUBIN: Just to respond to your --

VICE CHAIRMAN THOMAS: -- multiple denials and then, boom, you're in a position that's very significant.

MR. RUBIN: I don't think there are multiple denials, Mr. Vice Chairman. I think what there was, was an explanation of the affirmative role that the board played in terms of the structure and function of the institution when Mr. Prince stepped down.

I was then asked to be chairman of the board, which I did, and we had, I think, a four- or five-week search committee, and wound up with I think an outstanding selection of new CEO.

VICE CHAIRMAN THOMAS: And I understand all that but, Mr. Rubin, I guess what we're saying is that we can talk about boards of directors, we can talk about structure function, all we want in terms of corporate models.

Frankly, there are people in those positions, and you have a higher confidence in some people than others. Mr. Prince mentioned who he thought was outstanding. We've interviewed some of them.

At some point you can't understand an institution by simply following the lines of a structure function model or even the dotted lines. And what we're trying to say is it's really hard for us to believe, especially on my personal knowledge of you, an involvement in any institution that I'm aware you've been involved in, of this ability to fall back to a structure -- structure function model and argue about the box you were in. I have never, ever seen you accept the outline, the frame or the structure of a box.

MR. RUBIN: Well --

VICE CHAIRMAN THOMAS: Well, if you wanted to accomplish something that you felt fairly strongly about, and it's difficult for me to say we're finished, but I wanted to end on a compliment.

MR. RUBIN: Let me respond to the compliment because I think it's sort of a --

CHAIRMAN ANGELIDES: We'll make -- we'll make this your response to the compliment will be the last word.

MR. RUBIN: Okay. It's a rather mixed compliment.

VICE CHAIRMAN THOMAS: I reserve the right to amend the compliment based upon his answer.

MR. RUBIN: No, I said in my -- in my opening statement, Mr. Vice Chairman, that I had decided when I left Treasurer I was never going to have an operating role again. And that's precisely what I -- what we developed at Citigroup. And that's the answer to your -- your -- your compliment. Thank you.

CHAIRMAN ANGELIDES: And the record of today's Commission and discussion is what it is, and I want to thank, on behalf of the Commission, both of you for taking the time, for your time with us today, your answers to the questions. We appreciate it very, very much. Thank you so much.

MR. RUBIN: Thank you.

CHAIRMAN ANGELIDES: We will re-adjourn at 12:30, members. We will recommence at 12:30.

-------(Session ended.)-----

CHAIRMAN ANGELIDES: The meeting of the Financial Crisis Inquiry Commission will come back into order. This afternoon session will be devoted to looking at the Office of the Comptroller of the Currency with respect to that office's oversight of Citigroup and, in a larger sense, its oversight of financial markets particularly as it relates to subprime lending and securitization.

We have two witnesses with us here today, Mr. John Hawke, who is the former Comptroller of the Currency and Mr. John Dugan, who is the current Comptroller of the Currency.

And gentlemen, I'd like to start by doing what we customarily do, both for witnesses who have come before and will come after you, and that is to administer the oath to both of you, if you'll please stand.

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

MR. HAWKE: I do.

MR. DUGAN: I do.

CHAIRMAN ANGELIDES: Thank you so much. So gentlemen, just one moment here.

Gentlemen, I'd like to -- I know that you've submitted written testimony to us, and I think Mr. Dugan you've get the record for the amount of information, even though you did have a main statement. But I'd like to ask each of you to start today by providing some brief oral testimony, five -- up to five minutes each.

Mr. Hawke, I'm going to ask you to go first, as the former comptroller, and then Mr. Dugan. So, Mr. Hawke, if would you begin your testimony?

And if you could move that, not only turn it on, but move the mic toward you, sir.

MR. HAWKE: Thank you, Mr. Chairman.

CHAIRMAN ANGELIDES: Thank you.

MR. HAWKE: And Mr. Vice Chairman and members of the Commission, I am pleased to be able to participate in the work of the Commission, and I hope I can say something useful today.

I wanted to start by making two points. I touched on it in my -- in my opening statement, but I think they are very important. One, securitizations were really a creature of the accounting rules. We -- we had seen securitizations for many years. There was a time when they were sort of one-off transactions, an entity that wanted to increase its liquidity; to meet loan demand or credit card demand would securitize a bunch of receivables and other assets and go to market maybe once a year, twice a year, something like that.

Securitizations evolved into a constant, everyday method of raising the liquidity. And that process was facilitated by the accounting rules, which allowed institutions to treat assets sold as securitizations as off their books, provided that certain accounting criteria were -- were satisfied, basically that there were no contractual indemnifications or liabilities.

And if those rules were met the institution could treat the assets for financial accounting purposes as not on their books and the regulators would do the same thing. The regulators would not treat those assets as subject to capital requirements.

That -- that might be okay if there were no risks that resided with the institution after the securitization. But what we have come to learn in a painful way, particularly in more recent years, is that once the bank securitizes assets, there are several different kinds of risks that they retain.

On a simple level, they retain a liquidity risk, because if their securitizations start to go bad, they may have a harder time raising new liquidity in the marketplace.

But, more recently, what we've seen is that as they were wholesale defaults on the mortgages that were securitized, the trustees of the securitizations pools were very aggressive in putting loans back to the banks that had sold the loans, on the ground that representations and warranties that had been given at the time of the securitization had been breached, generally for some kind of fraud.

And -- and there were tens if not hundreds of thousands of loans that had been put back to banks, and that has precipitated in enormous amount of litigation and controversy at a time when banks themselves were under tremendous pressures.

I don't think any of us anticipated that -- that kind of risk in the process of securitization. And it raises the question about whether we should not have some capital requirements against assets that have been securitized and that are treated by the accountants and by the regulators as off the books to deal with those risks. And I think that's a subject that is worthy of investigation.

The other -- the other point is with respect to the way we measure capital. We have -- there was an old head of supervision at the Fed many years ago who, when asked how many capital a bank needs, said, I can't tell you but I know it when I see it.

And -- and we have evolved from that into a very highly technical set of rules for allocating capital. The Basel -- the Basel, as I sat on the Basel committee for six years and the Basel committee rules are mind boggling in their -- in their complexity.

And the -- the -- the one thing that we don't do with -- with respect to these increasingly complex capital rules is to measure capital, measure the value of capital accurately.

We -- we treat assets for the most part based on historical book values. Assets may get written down as a result of an examination. But we don't really look at what the -- what the true value, the true market value of the assets on the books of the bank are, I realize that fair value accounting is a very controversial topic, and I don't think we need to go all the way to fair value accounting to -- to satisfy the point that I'm making, but we have a system of bank supervision that's built on the concept --

CHAIRMAN ANGELIDES: Could you wrap -- see if you can wrap up in the next minute? I should have warned you and I -- but is that yellow means one minute to go.

MR. HAWKE: Okay.

CHAIRMAN ANGELIDES: If you could wrap up in one minute.

MR. HAWKE: I'll finish this very quickly. We have a system of supervision that's based on the concept of prompt corrective action, and that is that as capital levels fall, it should be increasingly vigorous supervisory action. But that whole concept fails if we're not measuring capital accurately.

CHAIRMAN ANGELIDES: All right. Terrific. Thank you very, very much.

Mr. Dugan, and let me just say, to start here, because the Vice Chair always has a favorite phrase that behavior has consequences, I actually want to thank you and the OCC. Of all the entities we've dealt with, you have been extraordinarily prompt in providing documents to us and making available witnesses, and we appreciate it. We understand you've done very well in that respect, so thank you.

MR. DUGAN: Thank you. Chairman Angelides, Vice Chairman Thomas, and members of the Commission, thank you for this opportunity to address your questions regarding national banks, subprime lending, federal preemption, and the supervision of Citigroup, all of which focus on the problems caused by deep losses on residential mortgages.

By the lack of adequate consumer protection contributed to the record levels of these losses, there was a more fundamental problem: Poor underwriting practices that made credit too easy, especially by unregulated mortgage lenders and brokers. These included stated income loans, the lack of meaningful cash down payments, payment option loans, and teaser rate adjustable mortgages.

In addition, without any skin in the game, brokers and originators had every incentive to apply the weakest underwriting standards that would produce the most mortgages that could be sold to mortgage securitizers.

And, unlike banks, most mortgage brokers in the United States were virtually unregulated. So there was no supervisory check on imprudent underwriting practices.

The rapid increase in market share by these unregulated brokers and originators pressured regulated banks to lower their underwriting standards, which they did, though not as much as unregulated mortgage lenders.

The OCC took a number of steps to keep national banks from engaging in the same risky underwriting practices as their non-banking competitors. That made a difference, but not enough for the whole mortgage system.

All these factors produced the worst under -- underwritten mortgages in our history. When house prices sharply declined, it led to record levels of delinquency, default, foreclosures, and loss.

However, the weak lending standards that caused the crisis were not the result of federal preemption of state mortgage lending laws. If it had been, the vast majority of subprime lending and Alt-A lending would have been done in national banks and federal thrifts, but just the opposite was true.

As described in my written statement, national banks and their subsidiaries made only 10 percent of subprime mortgages and only 12 percent of all non-prime mortgages from 2005 through 2007.

Conversely, 72 percent of all non-prime mortgages were made by lenders that were subject to state law. Well over half were made by mortgage lenders that were exclusively subject to state law. And it is widely recognized that these were the worst underwritten loans with the highest levels of foreclosure.

Now, I'm not suggesting that national banks played no role in the subprime lending crisis. They did. Some national banks originated poor quality, non-prime mortgage loans, some purchased badly underwritten subprime mortgage-backed securities, and some had significant exposure to subprime mortgage risk that they did not understand or anticipate, all of which produced very large losses.

But the relatively smaller share of non-prime mortgages made by national banks and their relatively better performance belie the argument that national banks' federal preemption caused the mortgage crisis.

Let me turn briefly to Citigroup: The critical -- rule -- role that subprime mortgage losses played in its problems and the OCC's supervision of its national bank subsidiary, Citibank. The overwhelming majority of Citigroup's mortgage problems did not arise from mortgages originated by Citibank, and indeed the bank's financial performance throughout the crisis was consistently better than it was for Citigroup as a whole.

Instead, the huge mortgage losses arose primarily from the collateralized debt obligations structured by Citigroup's securities broker-dealer with mortgages purchased from third parties.

By far the largest exposure of Citibank to the CDOs came from its liquidity puts that supported the CDO's super senior tranches. In the summer and fall of 2007, the 25-billion-dollar exposure to the bank, from these liquidity puts, came as a surprise to the senior management of Citigroup and to the OCC.

Subsequent review and investigation showed this to be both a risk management and an internal reporting breakdown by the company. It also revealed some of the supervisory problems caused by the legally segregated responsibilities of different regulators and the undue reliance on high credit ratings.

Citigroup, Citibank, the OCC, and other regulators have since taken a number of steps to address these issues.

In closing, there are many lessons to be learned from the mortgage problems that precipitated the crisis, but the one I would like to leave you with is this: I believe the government should establish minimum common sense underwriting standards for mortgages that can be effectively applied and enforced for all mortgage lenders, whether they are regulated banks or unregulated mortgage companies.

If we had had such basic across-the-board rules in place ten years ago on income verification, down payments, and teaser rate mortgages, I believe the financial crisis would have been much less severe than it was.

Thank you very much.

CHAIRMAN ANGELIDES: Thank you very much. We will now go to Commissioner questions. We will start -- I will defer mine till the tail end, and we'll start with the Vice Chairman.

VICE CHAIRMAN THOMAS: Mr. Chairman, I will probably defer most of mine to the tail end. But I want to respond briefly to a couple points.

EXAMINATION BY VICE CHAIRMAN THOMAS

VICE CHAIRMAN THOMAS: First of all, thank both of you very much. In the business of regulation a lot of folks come and go, and I'm pleased to see with just two people we've got a broad scope of history during a period when a lot of this was evolving. And that -- and that helps a little bit based upon the perspectives that you present.

Over the last couple of days, one conclusion that I have now locked down pretty firmly is that simplicity is not conducive to maximizing income if you're involved in any way on Wall Street. That's true to a certain extent in other professions. I think magicians learned it a long time ago, because you're fascinated with what they do until they show you what you're doing, and then you say, that's just because you practice it, but it ain't that big a deal.

I happen to think -- who was it, Therfer (phonetic), I think said -- For every complex problem, there's a simple answer, and it's wrong. So especially in this world today, I understand and accept complexity.

But having something complex and something convoluted for the purpose of having it be perceived what it isn't are -- are two different things. And one of my worries is -- and we're not responsible for setting up a structure which allows us to advocate to Congress what it is that ought to be the solution, thank goodness. But one of the things that concerns me, and just a quick reaction, because it's outside your area of expertise, but it came to me in the comments that you just made at the end, and that is I had been concerned for some time about the influence or -- my impression is of the influence, others may or may not agree, of the tax code, on the way in which people begin dealing with their homes; homes rather than houses.

You get into the flipping business and the rest I'm not concerned about that, but that the tax code really encouraged people, arguably, to pursue the American dream and wind up owning a home, but not the way it used to be where you owned the home, it was better than rent because you could get equity, and eventually you would have a mortgage-burning party and you accumulated wealth in your home.

In fact, there was some discussions that this was one of the American ways of saving not available to other societies to a certain extent, because they didn't own homes nor did the government assist in owning homes to the degree that the U.S. did and other societies.

But in 1986, on the tax committee, Ways and Means Committee, behind closed doors, we fought a pretty hard, tough battle because there was a desire and we, in fact, agreed to remove consumer interest as a deductible item on the tax form thereby damping down the consumer enthusiasm, because the government would cover a piece of the action in terms of the write-off on interest.

Wanted to do the same thing on mortgage interest, not tied very directly and specifically to improvement involvement with the house, and obviously it turned out that you created an environment in which the very creative folk in marketplaces would send you a check every month which represented the accrued equity in your home for that month so that you could spend it ostensibly on something about the house. But, of course, it went right back into consumer -- into consumption, totally negating, and more so, the argument about not wanting to have interest deducted on consumer demand and I think spiking it, and then you had the cheaper money.

Do you folks feel, at all, in any way, that that partially contributed to, assisted the environment in terms of the problem that we now face?

MR. DUGAN: Well, I'm certainly no expert on the tax policy, but I think there were a cluster of things that encouraged homeownership that fed on each other to stimulate demand --

VICE CHAIRMAN THOMAS: I haven't even discussed the societal and the government desire for everyone to own their own home, just like going to college, so you do everything you can to allow access to that, notwithstanding the fact not everybody ought to be able to participate in --

MR. DUGAN: But I think it's all part of that pattern that created the intense desire and demand for bigger, more mortgages and the -- also, as you said, the easy access to home equity through home equity lines of credit. Now there was a change. And it allowed much more equity extraction to be used for consumption and that had very significant effects. But it sort of fed on itself.

So I am no expert, but I think it did feed the whole notion of greater and greater demand for mortgages, mortgage credit that fed the securitization and the desire as well.

VICE CHAIRMAN THOMAS: Thank you.

CHAIRMAN ANGELIDES: Ms. Murren?

COMMISSIONER MURREN: Thank you.

EXAMINATION BY COMMISSIONER MURREN

COMMISSIONER MURREN: Thank you both for your very detailed and thoughtful testimony. I enjoyed reading it and I, though, wanted to go back to some of the witnesses that we've heard today and yesterday. I don't know, did you have an opportunity to hear the previous witnesses?

MR. DUGAN: Some of it but my staff heard it and I have been briefed on various aspects of what they say, so some of it, but not every bit.

COMMISSIONER MURREN: Well, my general impression was, from every single individual that we heard from, was that in their view, as a company, as managers, and as participants in their company and also in the financial crisis, that during the course of performing their duties and also the course of conducting business, that they felt very strongly that their risk management systems and the way that they dealt with risk and, you know, to use some of the words was excellent, very good, best in class, almost to the person, in fact, I think it was to the person, that they really validated their own opinion of their risk management policies and methodologies.

Does the fact that they all so strongly advance it or believe it surprise you in light of your reports and in light of what's happened?

MR. DUGAN: It doesn't change our view of what we thought their risk management was at the time or how it played out, I guess I would say. I think there were things that they well understood about the risks they took, others less so. We, on various occasions, pointed out problems.

I will say that when we pointed out problems to them, they were by and large quite responsive to them. But I also think that when the crisis hit, it revealed some problems that were of significant concern to us, which we did communicate to the company.

COMMISSIONER MURREN: There were a couple of instances prior to the crisis too, where you had noted some deficiencies in their risk management practices. Could you comment? You said that they were very responsive in remedying those things. Is that accurate or was it complete?

MR. DUGAN: I think that is accurate. I think what I was thinking about when I said that was we did a review of their credit derivatives, trading business in the bank in 2005, where we found a number of problems and concerns.

And we downgraded our rating of the management of that business and told them that they needed to fix things if they wanted to get that assessment of them improved.

They did curtail the risks that they were taking and they did take a number of steps to fix that particular problem. And we thought that is how the process is suppose to work.

COMMISSIONER MURREN: One of the things that you mentioned is that there are a number of different regulatory bodies that govern the overall enterprise. And specifically you mentioned that it was really not inside of the bank company itself which you monitored, where the problems arose, but rather other areas.

Could you maybe describe to us your interactions with some of the other regulators? Because if I'm not mistaken, and maybe you could comment on this, there was some interest in utilizing the information that was produced by the other regulators to be able to determine the safety and soundness of the bank.

So to what extent did you or did others that you interacted with make sure that information was validated and also that the right questions were being asked?

MR. DUGAN: So of course, in the way the bank holding company structure works, as I think you know, we were responsible as the primary supervisor for the bank and its subsidiaries. And the Federal Reserve was the umbrella supervisor for the consolidated company and the non-banking subsidiaries of the holding company.

And in some cases, those non-banking subsidiaries were themselves broker-dealers, for example, that were regulated by the SEC.

So that was a mixture of different regulators. And also we had futures Commission merchants that were regulated by the Commodity Futures Trading Commission.

We have, by long historical practice, a very close working relationship with the Federal Reserve as the holding company regulator. They see everything we do; they have access to everything we do; it's quite transparent.

I believe what happens in the bank, and there is tremendous amount of focus on what's going on in the bank, it's a little murkier when we go outside the bank to deal with issues that could effect the bank.

We rely on the Federal Reserve with respect to the affiliates for which it has primary supervisory responsibility. And as I said, we have a relationship where we're constantly sharing information.

When you get to the securities broker-dealer, by statute in the Gramm-Leach-Bliley Act, there are restrictions on our ability to get information from those companies and restrictions on when we could examine those companies.

And I do think that did and has created some issues in the process about not having as efficient and integrated supervisory model as we should have, and that showed up, in some ways, in the supervision of Citibank and Citigroup.

COMMISSIONER MURREN: One of the notations that we had made in the earlier conversation with witnesses was regarding some of the creation of new products which they would, of course, I believe, bring to the OCC to determine if they were able to sell them; correct?

MR. DUGAN: Not necessarily. There's not a prior approval requirement for new products with the OCC. However, particularly in the wake of the Enron situation, there was a tremendous focus put on making sure that institutions had new product committees and the right processes and the right due diligence and the right controls to examine those new products.

And then we would periodically go and examine those processes to make sure that on a test basis that they were appropriately looking at them. So that's the way the process worked.

COMMISSIONER MURREN: Okay. With that in mind, when you think about -- and one of the reasons that we chose Citibank to look at was the ability to shed light on practices that might have been common throughout the financial services industry.

MR. DUGAN: Right.

COMMISSIONER MURREN: In your opinion, with your perspective, do you think that it was common for companies to look at these products and to determine whether or not they needed to meet regulatory capital standards? Was that one of the ways they determined whether a particular new product was attractive to them?

MR. DUGAN: I'm quite sure that that factored into every decision. Much in the way that companies decide on the profitability of a particular type of product is a risk adjusted return based on the capital requirements that are allocated to that, so absolutely, that is a factor that people look at.

COMMISSIONER MURREN: Again, on a comparative basis, when you look at across the financial services industry, looking at a variety of different companies, when you look at them, are there certain commonalities that they all share in terms of their failures as we look back now, things that they might have done differently?

MR. DUGAN: There are some, yep.

COMMISSIONER MURREN: And what would those be?

MR. DUGAN: So, for example, obviously in the area that you're -- that this Committee is looking hard at, in the area of complex structured financial products in the CDOs, it was a surprise in the process, not just to the management of Citi, but to the management of several other companies, about the significant, sudden, and deep losses created on these instruments.

And I think there was not a full appreciation, a full examination of the -- of course, these were extraordinary events.

But of the -- in many cases, situations where companies have thought they had limited exposure to subprime risk from their direct lending activities only to find out that they had much more significant exposure than they thought coming from the securities side and, particularly, from the CDO side, we saw that in several instances.

I think the difference with Citi and with several other institutions that we do not supervise is they have so much more of it; it was so much bigger a concentration, which caused a much more significant problem when it hit.

COMMISSIONER MURREN: To the extent that the regulators are also responsible to some degree for examining that very issue, which is the concentration of risk, you know, particularly as it relates to the holding company, in a practical sense, how would that have been discovered based on what you described as being a little bit murky in certain areas?

MR. DUGAN: Well, I think in the case of the structured products, I think it is fair to say that Citigroup and its management, and I would say also the regulators, derived a false sense of security by the very high credit ratings on the super senior tranches, which ended up causing the big losses, not the tranches below it, which were riskier but which had been sold off, and interestingly, they did not cause as much loss even to where they were sold, because people used them and hedged them in different ways.

And so I think that was something that people did not adjust to or see as well as they should. I think the thing that surprised us, as I mentioned in my opening remarks here, was on the liquidity put. That was never treated even as an exposure to subprime losses by Citigroup. Even after problems started hitting and we began asking questions, we weren't told about the magnitude that was viewed as something that was an exposure of the bank. And that was unique to that institution.

COMMISSIONER MURREN: And what do you think explains that?

MR. DUGAN: I think that liquidity put is a kind of liquidity support facility that is not unusual in the sense that there were similar kinds of facilities provided for asset-backed commercial paper conduits that had been around for many years, that have worked well, and the actual liquidity facility was viewed as so unlikely to be exercised that it was not a significant risk.

And the fact was we did have an extraordinary situation. And, by the way, it was not supposed to be there for credit protection; it was only supposed to be there for liquidity protection. So if you had losses in a pool of assets, you couldn't exercise this liquidity put, or if you had a downgrade, you couldn't exercise it.

But what happened in this circumstances was the market started sensing things before the credit rating agencies did, there was a run on the commercial paper, and this seemingly liquidity only temporary facility ended up being something that was permanent and ended up taking on all the credit risks.

So it was partly an extraordinary event, partly because it was similar to things that they had done before, and partly was only tied to what was supposed to be the safest asset in that particular securitization pool that they never treated it as that kind of risk or -- and calculated even the magnitude of it when they talked about it.

COMMISSIONER MURREN: Would you also agree that one more component might be that it's difficult to evaluate the concentration of risk when you do have so many people that are involved with analyzing the underlying assets and liabilities of a variety of organizations, all of whom feed back up into an umbrella holding company?

MR. DUGAN: It can be, but a good risk system, of course, and you're exactly right in the sense that, you know, they were analyzing their subprime exposure from various other things and putting them together, and this one they didn't put with it, and it turned out to be huge. And so it was a breakdown.

COMMISSIONER MURREN: Thank you.

Mr. Hawke, I don't want to leave you out of my questioning, so I wanted to ask you, from your perspective, having been an observer of the financial services industry for some time, what changes in the regulatory environment do you think have influenced where we are today versus perhaps a very early part of your tenure?

MR. HAWKE: I'm not sure that changes in the regulatory environment, per se, were a major contributing factor to -- to the crisis.

I'm one who believes, and a lot of people disagree with me, that the regulatory structure --

VICE CHAIRMAN THOMAS: Mr. Hawke, can you pull the microphone just a little bit closer? Thank you.

MR. HAWKE: -- that the regulatory structure was -- was not a major -- major contributing cause. Nobody, clearly nobody would have invented this structure if you were developing a financial regulatory structure from scratch.

But in my experience, it has worked -- it has worked quite well. Not perfectly, by any means, but there's a high degree of coordination among the agencies. And while there are occasionally differences, today the system, I think, works, it generally works quite, quite well.

There -- a lot of people attribute today's problems to what they generally call deregulation, and they focus on the Gramm-Leach-Bliley Act of 1999. I don't believe that Gramm-Leach-Bliley was a contributing factor to the crisis. The -- I think Gramm-Leach-Bliley ended up turning out to be pretty much of a dead letter.

Once Citigroup's acquisition of Travelers was validated by Gramm-Leach-Bliley there was very little activity in the way of cross-industry acquisitions between insurance and securities and banking, banking firms. Paradox -- paradoxically, it wasn't until the crisis in over the last year or so that -- that Gramm-Leach-Bliley became an important factor in allowing companies like Morgan Stanley and Goldman Sachs to become bank holding companies where they couldn't have before that, but I don't think that if you characterize Gramm-Leach-Bliley as a deregulatory statute that it was a principal contributing factor to the problem.

COMMISSIONER MURREN: Would it be fair to say that it would make transparency better if though you were to be able to perhaps regulate more strongly or at least to reveal more about what the non-bank entities are doing in the financial services sector?

CHAIRMAN ANGELIDES: Let me yield another five minutes.

COMMISSIONER MURREN: Sure.

CHAIRMAN ANGELIDES: Five minutes.

MR. HAWKE: Oh, I think without question that's -- that's right.

COMMISSIONER MURREN: Thank you. Just one final question, really, on the -- the OCC reports on Citibank.

There were a couple of notations about their failures of the regulatory structure there and I wonder how strongly you took action in the face of those things.

Do you feel that as an enterprise that you have what you need to be able to put the kinds of muscle behind your recommendations or your observations that you need? And you had commented earlier that you felt like they were listened to when they were made by management -- when you made them to management. Is that an accurate characterization?

MR. DUGAN: Yes, it is an accurate characterization. The fact is when we do have a cause -- a course -- a cause to take action, we can do it quite effectively. We have very strong tools that we can exercise, do exercise, have exercised, in this circumstance, to get the kind of change and action that we want.

COMMISSIONER MURREN: Okay. Thank you.

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

COMMISSIONER WALLISON: Thank you, Mr. Chairman.

EXAMINATION BY COMMISSIONER WALLISON

COMMISSIONER WALLISON: Let me start with you, Mr. Hawke, if I may.

You were the Comptroller during the Clinton Administration, latter part of the Clinton Administration, and then through a portion of the Bush Administration. And I think I'm following up a bit on Commissioner Murren's question because I saw this somewhat broader.

Did you see any change in the way that regulation was viewed in the Clinton Administration or the Bush Administration?

MR. HAWKE: No, I did not, Commissioner Wallison. As a matter of fact, I found that in both the Clinton and Bush Administrations, the Treasury Department was exceedingly sensitive about the independence, statutory independence of the OCC.

And while we were obviously part of the Treasury Department and found strength in being part of the Treasury Department, I can't think of any instance where in either administration we had intercession on the part of the administration that was aimed at the way we conducted our supervisory and regulatory activities.

COMMISSIONER WALLISON: So these concerns that there was some kind of environment which did not favor regulation during the Bush Administration, at least, that's been one of the complaints, is it was not something that you noticed when you were a regulator?

MR. HAWKE: As I said, I -- I don't think that deregulation was a -- was a contributing factor, whether it was Gramm-Leach-Bliley or anything earlier than that.

COMMISSIONER WALLISON: I'm sorry to just follow this up again. And I want to talk about the environment, the zeitgeist, if you will, about regulation, because we read a lot, hear a lot about some notion that regulators were not regulating during the Bush Administration. Did you notice anything like that?

MR. HAWKE: No, as I say, we -- we kept a steady course in our supervisory and regulatory activities. We had extensive interagency discussions, but that is among the banking, the financial regulatory agencies.

But I can't think of single instance where the administration that happened to be in power at a particular time attempted to influence our supervisory or regulatory policy.

COMMISSIONER WALLISON: Thank you. Let me go on to another subject. You noted in your testimony that literally tens of thousands, if not hundreds of thousands, of loans have been put back to banks in the securitization process. That's really an important point, because many people act as though this originating-to-distribute idea means that no one has any liability after the loan is sold.

In fact, the banks or anyone else who has sold a loan does have liability. And you were concerned about that. The question I have, however, is wouldn't it be one of the things that a regulator ought to look at when a bank is holding loans that it is going to securitize to make sure that the loan is a good-enough loan to pass a securitization test?

MR. HAWKE: Well, I can -- I can't disagree that that would, in an ideal world, have been something that regulators might have done. Although my sense is that loans pass through the books of banks during the heyday of securitization quite rapidly.

They -- they -- they were not sitting around for -- waiting for examiners to come in and look at them. And I don't think anybody predicted this kind of response from the securitization trustees when they started trying to find ways to salvage the loans that were going bad in their pools by putting them back to banks on the ground that there had been some sort of fraud in the initiation of the transaction and that the representations and warranties that the bank had given at the time of the sale of the loan had been breached.

COMMISSIONER WALLISON: Let me turn, then, to the question that you mentioned, in fact, in your testimony, and that is, fair value or mark-to-market accounting.

Would you favor us with your views on how that affected the view of the condition of financial institutions, particularly banks.

MR. HAWKE: Well, this is a highly controversial subject, and I should say that I'm not an accountant, and I probably should not delve into this but --

COMMISSIONER WALLISON: If we leave this to the accountants, we'll never have a debate about this issue, so please.

MR. HAWKE: My basic point, my experience in this regard, is affected by my service as a director to the FDIC, a statutory role for the comptroller. It seemed that every time that a bank failed, and as we look back at the last examination report before the failure, the bank showed positive capital, but immediately after the failure it showed negative capital.

And -- and one had to conclude that things didn't change in a period of months so quickly. And my conclusion from that was that the real value of the bank's capital was not being adequately assessed, whether by the regulators or by the rating agencies or the marketplace or whatever.

And now, moving to full-blown fair value accounting is, as I say, a controversial issue, people talk about the volatility that that would create. But I think the regulators who are implementing a system of prompt corrective action have to -- which is what our system of supervision is based on, have to know what the real value of capital is. Otherwise prompt corrective action becomes a fool's paradise.

By the time you're really ready to act capital, real capital, may have already eroded. So the regulators have to know what the real value of capital is.

COMMISSIONER WALLISON: True. Do you suppose that the regulators or the market has a better idea of what the real value of capital is when there is no market?

MR. HAWKE: Well, and that is a good question. When there is no market I don't know that the market has any -- any better way of looking at it than the regulators do. There are ways, there are techniques for evaluating assets for which there is no --

COMMISSIONER WALLISON: Discounted cash flow, for example.

MR. HAWKE: Yeah, discounted cash flow is one of them. And not every asset can be valued on a bank's books with precision. But looking at real values is -- is important. And my favorite example of this is the -- is the situation in the savings and loan industry in the late `80s and early `90s.

Everybody knew that when market rates were up around 20 percent, and S&Ls had average yields on their portfolios of 6 percent, that they were underwater, that -- that -- that it -- and there was no way you could earn your way out of that. We had an insolvent industry.

Had the regulators -- and I think the regulators were fully aware of that. Had the regulators acted on the basis of what real market values were and had they done it incrementally, as interest rates started to go up, instead of waiting till the end, when it was just a cliff that you had to dive off, the -- some of the impact of the savings and loan debacle could have been avoided.

COMMISSIONER WALLISON: Thanks very much. Let me go on to Comptroller Dugan.

You have, uniquely, served in both the Bush Administration; you were appointed by George W. Bush; and in the Obama Administration.

I'm going to ask you the same question I asked Mr. Hawke, and that is, have you seen any significant difference between the regulatory environment? I call it the zeitgeist, that sense of whether regulation is important or not important, in the Obama Administration than you saw in the Bush Administration?

MR. DUGAN: No. I think -- I do think it's fair, however, to say that the world changed when we hit the crisis in how everybody was looking at this. I think the Treasury Department ended up playing a much more significant role because of the money it was distributing, so it became much more active than would otherwise be the case. That was true in the Bush Administration, under Secretary Paulson, carried over to the new administration.

But in terms of, as Mr. Hawke said, about interference, directing, we have very strict rules, statutory firewalls that prevent interference with the regulator, with the -- with the comptroller, even though we're a Bureau of Treasury on regulatory matters, and that has been observed in every case in both administrations.

COMMISSIONER WALLISON: You describe the financial crisis as the result of the worst underwritten mortgages in our history.

We've had a lot of focus on Citi here, and I'm going to ignore Citi for the moment, because there have been a lot of questions about that and there will probably be more. But there are about 200 banks, small banks, at least smaller than Citi, that are now failing. I don't suppose -- or have failed, already. There are 700 or so that are on the list of the FDIC as possible failures -- I don't suppose that all of these are -- are not national banks, that some of these are national banks?

MR. DUGAN: Sadly, yes.

COMMISSIONER WALLISON: Sadly, yes.

Now, it seems to me that if there's one thing that a regulator ought to be able to do is to make sure that a bank has complete files on loans and that it is only making prudent mortgage loans.

But we hear, at least, that most of these banks are failing because the loans that they had made, and most of these banks make mortgage loans, either commercial or residential, but principally residential, and hold them on their balance sheets. What is the reason that so many of these banks made loans that are now seeming to be imprudent? And what role could the regulators, particularly your office, have played in preventing that from happening?

MR. DUGAN: Well, I want to be careful here, because I was speaking about residential mortgage underwriting, not commercial mortgage underwriting.

COMMISSIONER WALLISON: Right.

MR. DUGAN: When it comes to the banks that have failed, there have been a number of thrift institutions that that have failed because of residential mortgage problems.

But I think all of the national banks that have failed, and certainly the overwhelming majority of commercial banks that have failed, small banks, have failed because of commercial real estate problems, not residential real estate things. In those circumstances, while there has been in some cases a decline in underwriting standards, it's as true if not more true that the problem is a concentration problem. It's a situation where they just have too many of these loans on their book, too many eggs in one basket, if you like.

And we did try to address this in regulatory guidance that started -- it was a long interagency process, that dated back actually to Mr. Hawke's era, and proceeded very controversial.

We did finally come out with guidance that set some benchmarks that were not hard caps on the amount of concentrations that commercial banks could have in commercial real estate lending. Very bitterly opposed by parts of the industry as being too prescriptive and we nevertheless finalized the rules. And, looking back on it, I think I worry that it wasn't actually strong enough and we should have done more.

And to your more general point, I do think there is a notion, and honestly this was a little bit surprising to me when I came from the private sector into the government, that regulators don't set underwriting standards.

And historically, that's not how things work. It's more been a notion of if you have a willing lender and a willing borrower, then they should be allowed to make a transaction provided that it's done in a forthright manner where people can -- consumers can understand the risk in a consumer transaction and the lender understands, appropriately measures, monitors, controls and manages the risk of the transaction.

What I suggest in -- is that, given the experience that we've gone through, that that paradigm didn't work very well --

COMMISSIONER WALLISON: Mm-hmm.

MR. DUGAN: -- in the residential mortgage space. And it's a place where there has been, if you like, a market failure that does require more prescriptive minimum government requirements. But critically they have to apply across the board. If any one significant part can end-run the others you can have problems.

COMMISSIONER WALLISON: One of your prescriptions, I've read the material you've been writing, and in your -- in your prepared statement is higher -- higher down payments, for example, for mortgages. I think you were talking about a 20 percent possible down payment.

MR. DUGAN: I haven't actually thrown out a number and it could vary in certain circumstances.

COMMISSIONER WALLISON: That's a very sensible approach. I guess the question I'm going to ask you now, is how do we bring that idea into an idea where we are expecting our banks and other financial institutions, but particularly the banks, to increase home ownership by offering mortgages to people who cannot make a down payment?

MR. DUGAN: There is a tradeoff, undeniably a tradeoff. If you put in we had a crisis in which credit was too easy and too many people got loans because of weak underwriting standards, if you strengthen those standards, fewer people will get loans, that is the tradeoff.

But I think what the crisis showed us was that people got loans that they couldn't handle. And that didn't help anybody.

And what I would suggest is that's something that the notice and comment process, how you do it is very important to sort out, number one.

And, number two, I think there are different kinds of programs that one could do in a very open and transparent way with people of more moderate means, whether it's through the Federal Housing Administration or through the VA.

Which, by the way, has had more success by holding to stronger underwriting standards, even of the lower down payments.

So there is not a one-size-fits-all thought here. It's just that we have to bring back some discipline to the system and some common sense minimum underwriting standards.

VICE CHAIRMAN THOMAS: Yield the gentleman five additional minutes.

COMMISSIONER WALLISON: Wonderful. Thank you very much.

I'm glad you mentioned an open and transparent way, because that, of course, is a really significant issue. If we want to improve home ownership in this country then there is an open and transparent way to do it, and that is to provide some sort of government subsidy for, we'll say, just to imagine it, down payments.

But what we did before, was we took institutions that the government controlled in some way but didn't actually fund, and said, and I'm talking here about Fannie Mae and Freddie Mac, and we said to them, you distort your underwriting systems and you produce these mortgages for us. Hands off, we don't have to put anything in the budget that -- that provides that benefit for the people we are expecting you to help.

So open and transparent I think is a really important issue here. And I'm grateful that you raised it. I have one other question, I think, because there was something in your testimony that really struck -- struck my eye when I read it. You note that 22 percent of non-prime loans, non-prime loans originated by national banks and their subsidiaries subsequently entered the foreclosure process, 22 percent, compared to a market average of 25.7 percent.

Now, I don't know, but I was fairly shocked by the idea that 22 percent of non-prime mortgages in any group of financial institutions would be in the foreclosure process right now. That's -- that's quite extraordinary. In terms of your knowledge of the industry, what's the multiple over the usual number of -- of -- of mortgages that are, or homes that are in the foreclosure process at this stage of a -- of a -- a deflation of a bubble, we'll say.

And I would like, actually, Mr. Hawke, after -- after you've answered too -- because he has also a very long experience in this business, to respond to that.

MR. DUGAN: Well, what I would say is we've never experienced something like this before. We've never experienced this kind of decline in house prices, including the Great Depression. If we had had numbers at that time, I'm betting that you would have seen an actual more significant decline.

And I'm, I guess, a little numb to the numbers. We've been collecting the most significant loan-level data on mortgages through a mortgage metrics report that we publish every quarter about this, and the trends for subprime lending, less so for Alt-A, Alt-A lending, but certainly there has been shocking and it's reached into the prime space, as well.

I'd have to get back to you for the record about historically what the multiples were, but it's an eye-popping number. And it's even, in some ways, higher for payment option mortgages, which in many cases were not subprime mortgages, they're more in the Alt-A thing, but some of the numbers in some of the states are just shocking how much -- how much of them have gone to foreclosure. But there are multiples of historical averages.

COMMISSIONER WALLISON: Thank you. Mr. Hawke?

MR. HAWKE: Commissioner, I don't have a statistic. But I do have what may pass for an insight, and that is that what -- what this reflects is faulty underwriting, faulty underwriting, not just faulty underwriting, but a basic corruption of the underwriting process.

Underwriting a loan is not a mystical science. The objective is to determine whether the borrower has a sufficient income to pay interest and principal on a loan without recourse to the collateral. And that's a point that we made over and over again in the various advisories that the OCC put out in probably half a dozen occasions in recent years where we have made that point.

And the -- the -- the loans that were made on the basis of stated income or -- or data that turned out to be fraudulent or faulty don't -- don't reflect flaws in the underwriting as such -- as much as they do a corruption in the process, because those lenders that were -- that were doing that really didn't care what the borrower's ability to pay current interest and principal on the loan was, because they were looking to the collateral.

And that was certainly true with the Alt-A and other kinds of alternative mortgage instruments, as I mentioned in my prepared statement.

Banks were not looking at the borrower's ability to handle the fully amortized market rate of interest-type obligations when the reset point came in those transactions and -- because they were relying on the immutable fact that housing prices only go up.

And it was that reliance on the value of the collateral rather than the conventional type of loan underwriting that -- that contributed to this high level of foreclosures.

COMMISSIONER WALLISON: Thank you. Mr. Chairman, I might have some questions at the end if we still have time.

CHAIRMAN ANGELIDES: Thank you. All right, certainly. Mr. Thomas has a quick question on this item.

EXAMINATION BY VICE CHAIRMAN THOMAS

VICE CHAIRMAN THOMAS: Just very briefly, I understand you're focused on national, but in the discussion with Mr. Wallison, there's community banks. I guess what I want you to do is either confirm or deny my thinking, and that is, with the growth of credit unions in terms of the degrading of what banks could do on a somewhat of an exclusive basis, savings and loans were really packaged on originate-to-hold, as you got into this business as originate-to-distribute on residential loans and then the warehousing structure, about all that was left of some community banks, as a business focus, was some of the commercial lending. And they stretched that farther than they should have, but is -- I mean, that's kind of where they wound up, wasn't it?

MR. DUGAN: There is that issue; that is to say, many of the retail loan products became more commodity-like and scale businesses. And it was harder and harder for community banks to compete.

A shrinking menu of things, and many, particularly in places in the country which had high housing development, in the sunbelt and the like, it became a very principled source of business.

And that's the conundrum, of course.

VICE CHAIRMAN THOMAS: Sure.

MR. DUGAN: Is that if you start moving in concentrations in that area, it's the basic bread and butter of what they do, and so how you do that is a very difficult problem.

VICE CHAIRMAN THOMAS: And at the same time, commercial establishments looking for loans, the others who were moving into the other products didn't have that much of an interest, and so they found themselves, unfortunately, to a certain extent, for a lot of community banks.

MR. DUGAN: That's right.

VICE CHAIRMAN THOMAS: Thank you.

CHAIRMAN ANGELIDES: Thank you. Mr. Georgiou?

COMMISSIONER GEORGIOU: Thank you, Mr. Chairman.

EXAMINATION BY COMMISSIONER GEORGIOU

COMMISSIONER GEORGIOU: Just want to follow up on something that Commissioner Wallison began, Mr. Dugan, and that is that back in 2007, you stated a number of times that subprime loans made by national banks in 2006 were becoming delinquent at about half the rate of the industry average; do you recall that?

MR. DUGAN: I -- I -- I -- I don't recall that specific. I remember saying they performed better. But I don't know. I don't recall that.

COMMISSIONER GEORGIOU: Well, because in your testimony on page 9, you now quote statistics showing that the default rate for national banks for non-prime loans, originated between `05 and `07 was about 86 percent of the market average.

Does that mean that they -- the national banks' relative performances -- has deteriorated, has worsened over the last few years, in your view?

MR. DUGAN: I'd have to go -- I'd have to go back and look at the original statement and compare the same data set of the subprime, not just subprime and Alt-A. I'd be happy to.

COMMISSIONER GEORGIOU: Would you mind doing that?

MR. DUGAN: I'd be happy to do it.

COMMISSIONER GEORGIOU: For us, and follow up in writing so we can clarify that? The -- you know, there are statutory protections administered by the Federal Reserve under Section 23 of the Federal Reserve Act which limit the amount of transaction between a commercial bank and its affiliates in order to protect the commercial bank from non-bank risks.

And while the Fed administers this Act, bank supervisors have an interest, you know, obviously have an interest in this subject, and I wonder whether the liquidity puts that we've been discussing at Citigroup were considered a possible 23A concern, in your view?

MR. DUGAN: I don't know that specifically, but to be a 23A violation, it would have to kind of loan to one borrower kind of concept, the amount of credit to an affiliate that exceeded 10 to 20, 10 percent of your capital, and that would be a big number with Citibank. So I'm not sure that would be in addition --

COMMISSIONER GEORGIOU: Well, the capital was less than 100 billion dollars, I think, at any relevant time.

MR. DUGAN: Right.

COMMISSIONER GEORGIOU: And as it turns out, they took 25 billion dollars of losses on liquidity puts and a total of 30, slightly over 30 billion dollars on the 43 billion dollars' worth of collateralized debt obligations. So it ended up being about a third, more or less, of their capital. So it would meet that test, I would say, as being significant.

MR. DUGAN: Let -- let me get back to you on this, because A, I'm not sure whether we've looked at it in those lights, but B, it also may be the case that when you have a contingent liability like that, it's treated differently than something that ended up being that kind of loss to the bank. I just don't know the --

COMMISSIONER GEORGIOU: Right. And then what about the warehouse lines of credit that were provided by Citi to customers of the investment banks, such as New Century, that we heard from yesterday?

MR. DUGAN: Those would be subject to 23A and 23B. Well, are you saying to New Century? That would be subject to the lending limits, that's -- because New Century wouldn't have been an affiliate, so it's not 23A and 23B.

COMMISSIONER GEORGIOU: Right. Right. No, that would be with the lending limits and the concentration, presumably, into this particular area.

MR. DUGAN: Right.

COMMISSIONER GEORGIOU: I guess one of the things that we were told, and if I can find it, by -- one of your examiners told our staff that the CDO business at Citi was managed outside the bank; it changed from an agency business to a principal business. And we don't know that. It's outside of our jurisdiction.

Gramm-Leach-Bliley would not let us really look into that, yet the bank had these liquidity puts that were not reported in any risk system that we had. If that was the case, how serious -- I mean, obviously it was a serious problem, how do we remedy that? I mean, is the structure preventing us from -- preventing you, really, and others responsible for getting it all the information you need to assess the stability, the safety and soundness of these institutions?

MR. DUGAN: I do think there's an issue here, and there is language that is in the Gramm-Leach-Bliley Act that makes it harder to get information from a functional regulator, which is what the SEC is, with respect to a broker-dealer.

And I say that not because the SEC was resistant to providing things, but it creates asylum and talent. And things that are done outside of the back are not as routinely in the purview of examiners to see and touch and feel and ask questions about and stir up.

And I think that we do need to have a better way to get at that information on a consolidated integrated basis. That is one of the things that was -- is in the financial reform legislation and I think is a good thing.

COMMISSIONER GEORGIOU: Okay. And it's in the financial reform legislation, that's what, moving to --

MR. DUGAN: To remove that provision in the Gramm-Leach-Bliley Act that put those kinds of restraints on the functional regulator. And for functionally regulated entity is now more easily subject to examination and supervision, particularly by the Federal Reserve, as the consolidated regulator.

VICE CHAIRMAN THOMAS: Gentlemen, yield on that point, briefly?

COMMISSIONER GEORGIOU: I'm sorry? Yes.

VICE CHAIRMAN THOMAS: In the House, past version?

MR. DUGAN: I believe it's in the House passed version and a version and in the Senate.

VICE CHAIRMAN THOMAS: And in the Senate. So it's in both.

MR. DUGAN: I think, I think so, but we'll get back to you on that.

VICE CHAIRMAN THOMAS: Yeah, thanks, well, I can check it, I just want to -- I think it's in both.

COMMISSIONER GEORGIOU: How much, if at all, I mean, I guess I'll direct this to both of you gentlemen, if at all did you understand that the collateralized debt obligation exposure of Citibank when you were examining it?

MR. DUGAN: Well, my understanding is this: We certainly knew that the broker-dealer was -- had a structuring business, and that structuring business had CDOs.

We knew early on that at times they were going to use liquidity puts, but at the time when they first started doing CDOs, the underlying collateral was not subprime collateral.

COMMISSIONER GEORGIOU: Was not, sorry, what?

MR. DUGAN: Was not subprime collateral.

COMMISSIONER GEORGIOU: What were they using?

MR. DUGAN: Regular mortgages, prime mortgages.

COMMISSIONER GEORGIOU: Right.

MR. DUGAN: And that was our understanding. Later, we began to --

COMMISSIONER GEORGIOU: But they were still using low-level tranches of the -- of the subprime mortgage securities, were they not?

MR. DUGAN: That was not my understanding of what we knew initially about the business.

COMMISSIONER GEORGIOU: Okay.

MR. DUGAN: -- Before.

COMMISSIONER GEORGIOU: All right.

MR. DUGAN: And later they began to use derivatives in a synthetic way to create CDO exposure. And that business began to put some of the super senior synthetic exposures in the bank.

COMMISSIONER GEORGIOU: Right.

MR. DUGAN: We did learn about that; we did go do an examination of our London branch office, our London office of the OCC examined their London branch office, and we did get a sense of the exposure there in the early months of 2007.

Although, I will say that the exposure that we ultimately got at the end of 2007 was quite a bit larger than what we thought it was at the beginning of 2007.

What we didn't know, though, was that there was a specific liquidity put on these CDOs. And we certainly didn't know the magnitude of the exposure. And that magnitude was never really reported.

And, you know, there -- there were liquidity facilities, as I said before, that were with other kinds of conduits, which were in the bank, which we would examine and which we would know about. We wouldn't necessarily know about every liquidity facility that was done.

But what I will say is during 2007 when problems started to emerge and we began pushing and kicking the tires harder, we weren't getting the answers that this was an exposure, and it didn't show up until the crisis hit. And that was a problem.

COMMISSIONER GEORGIOU: Right. And, you know, I don't want to belabor this, because I'm sort of tiring of saying it again myself, but -- but -- and -- and I'm sure everyone else is, but at some point this exposure -- well, first of all, there is been a contention, and I think it was from some people in the Fed, and the staff of the Fed have suggested this to us and others, that really there was a real regulatory and capital arbitrage game being played, here with regard to these liquidity puts. Because in -- when -- in the commercial paper market basically most people won't buy commercial paper unless it's backed up with a line of credit that's unconditional so that they can roll it over at the time and sell it.

And so if you -- if they gave you a 25 billion, if they put a 25-billion-dollar line of credit, unconditional line of credit on the bank books, then you would see it, you would know it, people would have to hold capital on it, and you would be looking at what their exposure presumably was for having to honor that line of credit. Would that be fair to say?

MR. DUGAN: Yes. But we'll go -- we'll go ahead with your term.

COMMISSIONER GEORGIOU: Okay. My point then being, is that by putting on -- putting the liquidity puts, using liquidity puts instead of a customary line of credit to backstop this commercial paper, several things happen.

One is it's off-balance-sheet, more -- less transparent to you, less clear to you that there is any particular risk to the bank. And the capital, as I understand, the capital is -- at least no more than one-tenth of the capital is required that would have been required had -- had the line of credit been --

MR. DUGAN: So here's how this works.

COMMISSIONER GEORGIOU: -- flat out?

MR. DUGAN: That's right. When you have liquidities facilities, and if -- and if it's a liquidity facility that's less than one year in duration, the capital rules say, and if it's truly a liquidity facility was the argument --

COMMISSIONER GEORGIOU: Right.

MR. DUGAN: -- that it was only there in case of a temporary liquidity problem, not to back up credit losses, then the current capital rules said 10 percent capital charge, 10 percent credit conversion factor.

COMMISSIONER GEORGIOU: Correct.

MR. DUGAN: If you had a full guarantee at a hundred percent, then you have a hundred percent credit conversion factor. It would be as if it were on your balance sheet.

COMMISSIONER GEORGIOU: Right.

MR. DUGAN: And, as I said, the argument was that if you didn't actually have a credit guarantee but you were only guaranteeing on a temporary liquidity basis, it should only be 10 percent.

You are quite right that what the crisis showed us was what was what was supposed to be a temporary liquidity facility, once it got exercised, ended up resulting in it being full credit support, and all of the assets came back onto the balance sheet.

As a result, the Basal committee, with the full support of the U.S. regulators has said that its credit facilities can't be at 10 percent. They've got to be at 50 percent.

COMMISSIONER GEORGIOU: Uh-huh.

MR. DUGAN: So it's not quite the same. And so that process is working its way through the America regulatory process.

But, in addition, this accounting change from

FAS 166, 167 is making it much harder as a general matter, in the first instance, to take those conduits and get them off-balance-sheet, at all.

COMMISSIONER GEORGIOU: Right. Which is another positive development.

MR. DUGAN: That's right.

COMMISSIONER GEORGIOU: But I guess, to go back to it, because I know Chairman Angelides has made this point, is that it really only took a 5 percent drop in the housing prices to trigger effectively a full recognition of that 25 -- those 25 billion dollars of liquidity puts.

And, really, that was because the underlying collateralized debt obligation was composed of all Triple-B tranches of the underlying residential mortgage-backed securities.

So those tranches were at the 7 percent and below level of the originating security; that is, 93 percent of the tranches were higher-rated, so obviously everything within the collateralized debt obligation, even the ones that were regarded as prime-plus or Triple-A-plus. I never really got an A-plus. I don't know, really, quite what that is. So when the underlying 7 percent-and-below-rated security tranche no longer was getting any cash flow because of the relatively modest diminution of housing prices and the resultant defaults, then all of the upper-level collateralized debt obligation failed and had to be brought back onto the books essentially and written off, really, in a very rapid succession there at Citi.

So -- and everybody who's testified here has said that neither the regulators nor the risk assessors nor the originators nor anybody else really regarded this -- this particular product as having essentially any risk of default, anything more than a 10,000 to 1 chance of default.

And is that -- I mean, obviously, in retrospect, we know that was not the case. But wouldn't it have been -- did any -- I guess let me ask it in a different way, because I'm not being very articulate.

Did you or any of your people ever look into these credit default obligations, I mean these collateralized debt obligations and have any suspicion that maybe they really weren't as solid as they were represented to be?

MR. DUGAN: I think that we did think that there was some pricing risk in one of our exams that we noted with the CDOs in 2005. But I don't think there was a fundamental question of the kind you're suggesting that the super senior exposure didn't have quite a remote level of risk.

The other thing I'll mention to you, though, is the further thing they would say is, if there were a downgrade, a credit downgrade as a result of the 5 percent drop, the liquidity put could not be exercised; it wasn't there to take into account.

What happened was confidence got lost before there was a downgrade, investors started to run, that was a true liquidity event, not a credit event, the liquidity put got exercised, and it was supposed to be on a temporary basis, and once the, you know, the liquidity squeeze went by, they would be able to resell and roll --

COMMISSIONER GEORGIOU: Right, of course, they never --

MR. DUGAN: -- them over. It never happened.

COMMISSIONER GEORGIOU: Of course it never happened.

MR. DUGAN: Of course it never happened, right. So the point is --

COMMISSIONER GEORGIOU: Right.

MR. DUGAN: -- that what was styled and put forward as an extra protection proved to be illusory.

COMMISSIONER GEORGIOU: Right. So in -- so what are we -- what's to be done about that?

MR. DUGAN: Well, I think what I said was, number one, there's much greater -- much more suspicion about credit facil- -- liquidity facilities, in general.

We -- the U.S. had -- used to be under the original Basal rules, it got a zero risk rating --

COMMISSIONER GEORGIOU: Right.

MR. DUGAN: -- and we were the ones who put it at 10 percent. Basal's bumped it up to 50 percent, and as I mentioned, the accounting rules have changed to make a bunch of these securitizations not possible.

COMMISSIONER GEORGIOU: Right. One more question.

CHAIRMAN ANGELIDES: Yes, I'll yield two minutes.

COMMISSIONER GEORGIOU: Thank you.

I don't want to go too far into the accounting rules, but can we all agree with regard to mark-to-market that whether you believe in it or don't believe in it, one thing we can all agree on is that you're not permitted to do it on the upside and not on the downside?

MR. DUGAN: I guess that's right. Although, I must say I disagree with Jerry on the mark -- the fair value accounting point, but yes.

COMMISSIONER GEORGIOU: But I mean but we saw historically at several companies, not in the financial business, at Enron, for example, where they -- mark-to-market, a number of assets that they characterized as having increased in value quarter by quarter, this was a significant element of their recognition of income, so you're not -- I mean, you certainly ought not to be permitted, as a financial institution, to mark it up but never to have to mark it down.

MR. DUGAN: And I don't think that was the case in this instance. Once it was in the trading book, it was being marked and going up and down, and that's why you had the very sudden, precipitous losses --

COMMISSIONER GEORGIOU: Right.

MR. DUGAN: -- in the fourth quarter of 2000 --

COMMISSIONER GEORGIOU: And to follow up just on the capital issue there, isn't it also the case that if it's in your trading book, there's very little capital required to sustain it?

MR. DUGAN: So if -- so if you hold the piece, not if you sell it.

COMMISSIONER GEORGIOU: But if you hold the piece, right?

MR. DUGAN: If you hold the piece and it's on your books, it's treated as a securitization exposure. And the way super senior exposures were treated, actually, was the same, whether it was in the trading book or the banking book.

You are right, however, that in many cases, the trading book valuations were way lower than what the banking book was, and that was true for a number of securitizations. It's one of the things we pushed very hard to change, already, at the basal committee, because to prevent that kind of arbitrage, that also is making its way back into the U.S. capital.

COMMISSIONER GEORGIOU: Right. I mean, we've got somebody from the Fed who told us that if it was kept on the trading book, the capital requirement was something like 70 -- the regulator -- the leverage was 750 or 800 to 1.

MR. DUGAN: That's true.

COMMISSIONER GEORGIOU: That's how little --

MR. DUGAN: But you also have to remember there was a leverage ratio that applied on top of that, so it's a matter of risk-based capital, that's true, but there was a much higher piece --

COMMISSIONER GEORGIOU: Right.

MR. DUGAN: -- that applied, just as a straight on balance sheet.

COMMISSIONER GEORGIOU: Okay, thank you, Mr. Hawke wanted to respond to that and then I'm done.

CHAIRMAN ANGELIDES: Go ahead and respond.

MR. HAWKE: Just very briefly I want to clarify my position, and that is, I'm not an advocate of going to full market value accounting for all purposes.

I look at this in the context of the process of prompt corrective action. But what the regulators are supposed to be doing is taking increasingly stringent supervisory action. As a bank's real capital approaches zero. It's a protection against insolvencies.

And from a supervisory point of view, I think it's important to know what the real value of capital is on the downside. The -- I've heard arguments about -- about the upside. I've also heard arguments that as a bank's assets deteriorate in value the -- their liabilities increase in value, which is an anomaly, but that -- that's not completely relevant for prompt corrective action purposes.

COMMISSIONER GEORGIOU: Okay. And -- and I take it you would agree with Dr. Greenspan's suggestion yesterday that it, particularly for institutions as complex as Citi --

CHAIRMAN ANGELIDES: I will yield you another minute.

COMMISSIONER GEORGIOU: I'm sorry. As complex as Citi that we need much more capital and higher capital and liquidity requirements; is that fair to say?

MR. DUGAN: I have testified, generally, that systemically important institutions, particularly institutions with trading requirements, need higher capital, generally.

COMMISSIONER GEORGIOU: Mr. Hawke?

MR. HAWKE: I would agree with that.

COMMISSIONER GEORGIOU: Okay. Thank you. Thank you, Mr. Chairman.

CHAIRMAN ANGELIDES: Mr. Holtz-Eakin?

COMMISSIONER HOLTZ-EAKIN: Thank you, Mr. Chairman.

EXAMINATION BY COMMISSIONER HOLTZ-EAKIN

COMMISSIONER HOLTZ-EAKIN: Thank you, gentlemen, for taking the time to come today. I'm going to begin with some well-trod ground, and I apologize for that, but I wanted to ask you in particular, Mr. Dugan, some questions that I asked the Citi grant -- Citibank panel this morning.

And so, Mr. Dugan, the OCC's current examiner in charge of Citibank said that when he first came into Citibank in October 2007, he quickly determined that Citibank's entire risk management structure needed to be revamped, and he embarked on a course of action to require Citibank to change its entire risk management structure. Is it reasonable to infer from that judgment that the prior risk management structure of Citibank was deficient in some respect?

MR. DUGAN: I think what I would say is that when we had the crisis, it revealed things that were not apparent when we didn't have the crisis.

And, in particular, we were quite concerned that the risk management was not sufficiently independent from the line of business, and that in a couple of very significant cases, it had agreed to increase limits and ramp up risks in ways that we did not think was appropriate, particularly with the problems that were apparent on the trading side as opposed to the loan side, that that was a serious, significant thing that needed to be addressed.

COMMISSIONER HOLTZ-EAKIN: Had there been previous OCC reports that suggested deficiencies in the risk management structures at Citibank?

MR. DUGAN: There were, as I mentioned earlier, earlier reports where we did raise significant objections on risk management, downgraded them with respect to particular businesses, as we did with the credit default swap business, and which they then responded and took steps to address.

But it was not a situation where we had criticized the whole structure and believed it should be, as I said, that was more a thought that came out of the deficiencies that were revealed in the crisis.

COMMISSIONER HOLTZ-EAKIN: Okay. Just so I understand the details, you did, in fact, issue a downgrade to the risk management rating in the past?

MR. DUGAN: With respect to the particular business that we --

COMMISSIONER HOLTZ-EAKIN: With this particular business?

MR. DUGAN: Yes.

COMMISSIONER HOLTZ-EAKIN: And you were satisfied with the Citibank response in this instance?

MR. DUGAN: Yes.

COMMISSIONER HOLTZ-EAKIN: The 2007 report does say, regarding the role of the boards in particular, that traditionally the board has been provided limited information on the material risks impacting this legal entity. Consequently they have been unable to become fully familiar with the risks assumed within the bank. Isn't that a serious charge against the bank's board of directors?

MR. DUGAN: It is, but you have to understand this in context. What we were talking about now is the bank, the board of directors of the bank. And I think Citi, like some other companies, was running the whole organization by line of business and not paying as much attention, as we would like, to the legal entity of the bank and separately having it have the right risk reporting that is particular to that bank. And it gotten too far away from it. The new EIC, when they came in, was particularly focused, has continued to be particularly focused on that, and the company has moved in that direction.

COMMISSIONER HOLTZ-EAKIN: In fact, their response was to say the company is proud of its board processes both at the parent and the bank level.

What's your personal opinion of the

effectiveness of the board both prior to and after your review?

MR. DUGAN: I think we believe that the board, at the bank level, and we had believed this for quite some time, needed to be more independent and operate as a more of an independent rather than them being staffed with too many insiders on the bank board.

And so we did believe that that was some step that absolutely needed to be taken, particularly, as I said before, when we became aware of this breakdown that occurred in the internal reporting in connection with the liquidity put and the huge liability that came back onto the bank's balance sheet as a result of what happened.

COMMISSIONER HOLTZ-EAKIN: Thank you. I know you've answered a lot of that before, but they were asked the same questions.

MR. DUGAN: Yes.

COMMISSIONER HOLTZ-EAKIN: This morning's discussion about Citi was intended to talk about the industry as a whole, and so I guess what I would ask you is was Citibank unusual in any of these regards or was this typical of the risk management challenges and internal reporting and monitoring facilities that are in the industry and for national banks as a whole?

MR. DUGAN: Citi was unusual in our large bank experience because the bank was a smaller proportion of the overall company than is typical, even for our very largest banks.

So it was less than half of the assets of the overall company, until recently, when they began downsizing. So they had a huge non-bank piece of it, and that affected the culture and the way things were done in ways that were different, historically, than some of the other institutions that we supervised.

COMMISSIONER HOLTZ-EAKIN: So is it a fair characterization to say that on net, they were below the industry standard for management of these risks?

MR. DUGAN: It was different. As I said before, I think we felt they had a firm grasp of risks that they were -- understood a bunch of things, but that their appetite got bigger, and that appetite to take more risks spilled on risks that they thought they understood well, turned into some very big bets on things that created quite large liabilities, not just for the company as a whole, but for the bank, and that was different.

COMMISSIONER HOLTZ-EAKIN: Thank you. I wanted to turn to another oversight issue, which is, we understand that the OCC came in at the request of OFHEO, now FHFA, in the summer of 2008 to review Fannie Mae.

What can you tell us about the risk management system and capital levels of Fannie Mae compared to national banks of similar size?

MR. DUGAN: So we were asked by the Fed to go into both Freddie and Fannie. And to -- we didn't do an examination, this is important, and we did not review what they would be like under their legal structure and their legal capital requirements.

We were asked to say if this were a bank what would its capital requirements be; how would they look? And we had our expert retail examiners work on that review.

And where we came out, and just by some very simple arithmetic bolstered by the results of what we did, I think it's fair to say that they would have been treated as significantly undercapitalized at that point. Based on Fannie Mae and Freddie Mac, all their mortgage-backed securities get a hundred percent credit guarantee, and in a bank world, all of that stays on the balance sheet.

If you have us back to your point that was raised earlier by Commissioner Georgiou, if you have a hundred percent credit guarantee, it's on your balance sheet.

And by statute, the rules for Fannie and Freddie and their risk-based capital rule had a credit conversion factor that was far reduced on that, presumably under the theory that mortgages just weren't as risky, but that's just not the way we would do it. And had that come on the balance sheet in the denominator, in the numerator they were allowed to count more of deferred tax assets as an asseting capital than a lot more than we would allow.

Now you put the two of those together, plus the fact that the way they did their reserving practices, their credit reserving mortgages was considerably less rigorous than what we would do on the bank's side; it was a significant effect on their capital position.

COMMISSIONER HOLTZ-EAKIN: Did these findings surprise you in any way?

CHAIRMAN ANGELIDES: I'm sorry, could you repeat what you said? I somehow didn't hear it, could you repeat that question?

COMMISSIONER HOLTZ-EAKIN: Did these findings surprise you in any way?

MR. DUGAN: I don't know that we were surprised in the sense that, you know, it was a company that was totally and a hundred percent in the mortgages business, and mortgages were having trouble, and we knew statutorily they had a regime that had a lower regular capital ratio than we did. I think that the question that the Federal Reserve and others were asking us is just what is your view so that they can take that into account in the subsequent policy actions that they took.

COMMISSIONER HOLTZ-EAKIN: One of the unique features --

VICE CHAIRMAN THOMAS: Are going to continue that line of questioning or are you going to shift to something else?

COMMISSIONER HOLTZ-EAKIN: It's related.

VICE CHAIRMAN THOMAS: Okay, because then I want to get in on this at the end.

COMMISSIONER HOLTZ-EAKIN: I would never leave you out.

VICE CHAIRMAN THOMAS: And I -- and I got time to give.

COMMISSIONER HOLTZ-EAKIN: Okay. One of the unique features of Fannie Mae and Freddie Mac is in the fact that your banks and others can hold unlimited amounts of their securities and their portfolios under the presumption that they are as riskless as treasuries.

Knowing that they were, in fact, not, because nothing about this examination surprise you, did this give you any concern about the safety and soundness of those which you supervised?

MR. DUGAN: Well, it is, you know -- statutorily, they have always received a favored position in what they can be invested in because of the quasi-governmental status of the institutions.

And it did have effects on institutions that caused the failure of a number of banks, including several that we supervised, smaller ones, so, yes, it was a concern.

COMMISSIONER HOLTZ-EAKIN: And did you express this concern to other regulators or in any way attempt to change this treatment?

MR. DUGAN: We have not taken; the write-downs were occurred, and it was more in the -- preferred stock was where the big hit was taken when that got wiped out. That was the part that got done, but we have not changed the capital rules on that.

COMMISSIONER HOLTZ-EAKIN: I yield to the Vice Chairman.

VICE CHAIRMAN THOMAS: Thank you, and it will be on my time, and you can have some more if you want.

COMMISSIONER HOLTZ-EAKIN: Okay.

EXAMINATION BY VICE CHAIRMAN THOMAS

VICE CHAIRMAN THOMAS: I want to put this in context, because I was going to talk about this later, but it's kind of a preview of coming attractions for tomorrow as you indicated. But you were asked to look at Fannie Mae and Freddie Mac after the conservator?

MR. DUGAN: Before.

VICE CHAIRMAN THOMAS: Before?

MR. DUGAN: Oh, well, let's say, yes, before the conservatorship.

VICE CHAIRMAN THOMAS: And -- and you were requested to come in by?

MR. DUGAN: The Federal Reserve, who was conducting the exam, and they wanted help from our expert retail credit examiners because we have a tremendous amount of retail credit experience in the national --

VICE CHAIRMAN THOMAS: And did it reflect, at all, in your opinion on the regulatory structure that they were ordinarily operating under? Any -- I don't want to use the term deficiencies, but perhaps undermanned or anything else about OFHEO or FHFA?

MR. DUGAN: I guess that wasn't the way we were looking at it. We were trying to help; there was obviously a very --

VICE CHAIRMAN THOMAS: But the only reason you're asked to help is because the folks who are supposed to row the boat can't.

MR. DUGAN: And I think they -- the reason why I'm hesitating is they had a different regulatory structure and a different mandate and a different set of rules that they were operating under.

And we weren't asked to look at those rules and say, are you deficient? We were asked to say, now, if this were a bank, how would you treat it? And so we were happy to provide that because that's an expertise we had.

VICE CHAIRMAN THOMAS: And why do you think you were asked to look at it that way, which, after all, was different than the way it was supposed to operate under while on regulatory structures?

MR. DUGAN: I think there was concern by -- at the time by the Federal Reserve and by the Treasury Department about the ongoing solvency of the companies. And they wanted to get some other judgments about that from different regulators who had expertise with these kinds of instruments.

VICE CHAIRMAN THOMAS: You know the old jag about going across the suspension bridge, and you don't want the troops to march in step, you want to break that pattern, is it your observation, would you be willing to say, that it -- it wasn't just the size, but obviously it was the lockstep, the single theme of Freddie Mac and Fannie Mae in terms of what they were involved in was a concern? Or was is it just the sheer size and what was deteriorating around them?

MR. DUGAN: I don't know that I can comment. I mean I think, as I said before, a company that's a hundred percent in the United States mortgage business when it has a crisis in home values that drops the value of those mortgages is going to raise concerns at any time. The same thing happened, you could say, with the thrift industry, not once, but now twice. And the largest of those institutions had very substantial strains on them as well and ultimately had to be taken over or acquired.

VICE CHAIRMAN THOMAS: And when you're dealing with people, helping them get a mortgage to own a home on the way up, it's all good, and more is better until?

MR. DUGAN: Yeah, as I said before, I mean, I think we had a whole cluster of things that cause us to loosen our underwriting standards when times are good in the name of home ownership.

Of course, Fannie and Freddie did have some statutory down payment requirements, but in what happened and how those were done over time, they proved not to be adequate protection for what later happened.

VICE CHAIRMAN THOMAS: Just very briefly, you were asked to intervene?

MR. DUGAN: Yes.

VICE CHAIRMAN THOMAS: Did you -- did you consider it a positive experience, and was there some cross-fertilization of knowledge and understanding, although people are talking about Fannie --

MR. DUGAN: Yes.

VICE CHAIRMAN THOMAS: -- and Freddie Mac not being there anymore?

MR. DUGAN: Yes.

VICE CHAIRMAN THOMAS: For you, in your particular area of expertise and responsibility?

MR. DUGAN: Yes. I mean I think it was -- we were -- I think we were appreciated the recognition of our expertise in this area. And we learned things by looking at this quite unusual institution.

And I think there was coordination not just between us, and cooperation between us and the Federal Reserve, but also with the then-Office of Federal Housing Enterprise Oversight, which is now the GSC regulator of FHFA.

VICE CHAIRMAN THOMAS: One last question. We're worried about what the structure needs to look like, where and how we can deal with this, and people are talking about a super agency or reinforcement in the smaller.

Do you have any sense that if you've got some folks who have a type of speciality, given the complexity and the blending of what's going on, that it might be useful to have some folk who aren't so locked into a narrow area but that you can be called on, when necessary, so that your expertise is unique, but you don't have to replicate it in whatever regulatory structure is available?

And that might be a part -- partial model that might be useful, the cavalry coming to the rescue, when and if it's necessary.

MR. DUGAN: I think it is a good idea to tap into areas where particular agencies may have some comparative expertise or things to contribute in other areas, and so not just this area, but when we did the senior supervisors group in the wake of the -- in the heart of the crisis and looking at lessons, it's the same kind of ideas. There are things where agencies can go outside their normal zone to help out in other areas. I'm all in favor of that, you raise a good point.

VICE CHAIRMAN THOMAS: And the downside, of course, is it's almost always after the fact.

MR. DUGAN: Unfortunately, yes.

CHAIRMAN ANGELIDES: Before we move on, Mr. Thompson, I believe Mr. Holtz-Eakin.

MR. HOLTZ-EAKIN: Briefly.

CHAIRMAN ANGELIDES: I'm going to grant you two minutes.

EXAMINATION BY COMMISSIONER HOLTZ-EAKIN

COMMISSIONER HOLTZ-EAKIN: Briefly, Mr. Hawke, I wanted to ask you essentially the same questions. You had the, I guess, the good luck to serve prior to the housing bubble and -- and financial crisis.

Are you surprised by what you hear about the state of risk management, risk exposures, that we learned about at Fannie Mae and Freddie Mac?

MR. HAWKE: Well, I have to say, yes. The -- I never had an occasion to look at the risk management systems at Fannie Mae and Freddie Mac before.

COMMISSIONER HOLTZ-EAKIN: So do you think you would have benefitted from the ability to examine the underlying economic riskiness of these entities before allowing your banks to hold large amounts of their preferred stock and securities?

MR. HAWKE: Oh, I think undoubtedly had -- had we had more information about Fannie and Freddie, it would have helped in our assessment of investments that our banks had and their obligations.

COMMISSIONER HOLTZ-EAKIN: Thank you.

CHAIRMAN ANGELIDES: Mr. Thompson?

COMMISSIONER THOMPSON: Thank you, Mr. Chairman.

EXAMINATION BY COMMISSIONER THOMPSON

COMMISSIONER THOMPSON: If I might, I would like to shift the focus of the discussion, just a bit.

If we were to go back to the very first round of hearings that we had, Commissioners Bair and Schapiro commented about the effectiveness of their agencies and their execution of their role, and when asked while regulations or more regulations would be helpful, would existing regulations, if well-executed, would they have blocked or stopped this activity or effect? The answer was, it was, in fact, a supervisory failure. So my question --

MR. DUGAN: Pardon? Sorry?

COMMISSIONER THOMPSON: It was a supervisory failure.

MR. DUGAN: Okay.

COMMISSIONER THOMPSON: So my question of you is, were there things that OCC could have done in this process that might have forestalled or at least identified some of the risk? And do you feel that, perhaps, there were some shortcomings in OCC's execution?

MR. DUGAN: So I would say, there were some things we did and saw in a timely way and other things less so.

So when I first came to the agency, our examiners were getting very uncomfortable with what was then called exotic mortgages, payment option mortgages and the like, and not only the offering of them, but the layering of the risks over that with stated income and some other things.

And so we became very active in that area, early. We got out with speeches and then, ultimately, with guidance. We applied that guidance quite strongly in a horizontal way to our banks, and we basically did not have a payment option mortgage, exotic mortgage problem in our system.

I regret that we didn't act sooner on stated income mortgages, more generally. And a year later I gave a stronger speech in the context of subprime mortgages. But that, the stated income there, the low-doc mortgage area was a place where we just lost our way, not just the OCC, but all the regulators did.

And it's something that not only was wrong, in and of itself, but it was an invitation to fraud in the actual doing of the business, because it invited people to lie about their income, which many people did, and it was an unhealthy thing that we should have acted sooner and stronger.

And it goes back to the point I made earlier about we needed to be more muscular about imposing underwriting standards.

I think the other piece of that, though, is what I said before. There was a constraint on doing that, and there was a constraint even when we did it with the nontraditional mortgages that you had to get the consensus of all the other regulators, that took time, and you couldn’t get this huge chunk of the mortgage system that was operating outside of federal purview. And industry participants would say, we wouldn't mind doing this if you apply this across the board, but if you don't and you apply it individually, you'll take us out of this business.

And that is an inappropriate -- now we went ahead with that, but it's a powerful argument at times for businesses. And so that's why I feel so strongly that having -- going back to common sense underwriting standards but doing it in a way where you can apply it across the board is so important.

COMMISSIONER THOMPSON: Well, you comment on your agency's ability to keep pace with the innovation.

MR. DUGAN: I think that's always something that we struggle with, to try to maintain the expertise, we work very hard at this. We do it by how we train our existing people, but continually trying to renew it with external training and hiring industry hires who have expertise in particular areas.

I think in many parts of what we did during the crisis, actually, in some of the most complex areas, that supervision proved very effective. And, you know, I wish that we were in a better spot with the super senior things, of ABS CDOs, but honestly, not only did we not see it, but nobody in the industry saw it. The only difference between those who had a lot of losses and those who didn't are the ones who piled into that in huge ways.

COMMISSIONER THOMPSON: How stable are the exam teams themselves that are a part of the review process, the attrition rates, skill levels, experience? Can you comment on that?

MR. DUGAN: Yes, I can. We spend an awful lot of time on this as well. We have excellent stability rates, although we always worry about the demographic of an aging examiner force, as so many companies have. We embarked on a very significant hiring process, which actually began in former Comptroller Hawke's tenure that I continued in ours to really make sure we were getting a pipeline of people.

We were worried that a whole generation of seasoned examiners that had been through the `80s would retire and we wouldn't be able to replace that expertise. But we found a way to do that by having this crisis. So now we're training all our young examiners. And so we're now able to get this --

COMMISSIONER THOMPSON: Whoops.

MR. DUGAN: -- knowledge transferred, not exactly the way we would have done.

So the OCC has the very high esprit de coeur. It is partly because of very focused mission, all we do is supervision. And if you look actually at surveys of best places to work in the federal government and even in the United States, we rank high and we prize that. We work hard at it.

COMMISSIONER THOMPSON: Some say that the back-and-forth between the public and the private sector for some of the people who are in oversight or supervisory roles creates an inherent conflict. Do you agree or disagree with that?

MR. DUGAN: I disagree.

COMMISSIONER THOMPSON: Given that you're from --

MR. DUGAN: Well, I am, but I am one person. I was a lawyer. I was in private practice. And I think it's good to bring some expertise coming in. We do hire people from the private sector as well, from time to time.

Although I will say, the core of our examiners is made up of people who come out of college and worked their way up through the ranks, get commissioned as a national bank examiners and then find their way. I honestly don't think that is an issue, at least in our supervision.

MR. HAWKE: Can I -- yeah, I'd like to -- since I've been in and out of the government several times in my almost 50 years in Washington, I have a very strong view on that. I think -- I think -- I think it is enriching both to the private sector and the public sector to have mobility in and out of -- out of government.

The -- the notion that people come out of government and immediately start trading on their experience and go back and exercise significant influence over their colleagues is just wrong, in my experience. If anything, if you go back to your old agency after the period of quarantine is over, you're likely to be under a heavier burden than somebody who hasn't been there in the past.

But in any -- in any event, I think that people who have been in the agencies, understand the agency's concerns and problems, and can transmit that to the private sector, and people who come into the government from the private sector can bring perspectives and experience that are very valuable.

So I think arguments about the revolving door are frequently, generally misplaced.

COMMISSIONER THOMPSON: Okay, good. It's encouraging to hear that OCC would be considered one of the best places to work in government. Does that mean that you don't have challenges attracting talent?

MR. DUGAN: No. I mean, I will say that I have been very impressed with the talent that we've been able to recruit from colleges across the country. And I always worry when we get into the areas that you were talking about earlier, the more complex areas, can we find people, but I think we have been able to attract the talent.

And honestly, when you get into a recession and people don't have jobs, you've got another pool of talent of people that are willing to come on and take the job.

And there are benefits. And I don't mean that just in the monetary sense, benefits of being -- of working for the government that aren't the same as being in the private sector that people value.

COMMISSIONER THOMPSON: All right. Thank you very much. I yield the balance of my time.

CHAIRMAN ANGELIDES: Thank you, Mr. Thompson. We need a break? Ms. Born? Mr. Thomas is asking for a five-minute break.

VICE CHAIRMAN THOMAS: Yes.

CHAIRMAN ANGELIDES: Oh, just five -- for the gentlemen.

VICE CHAIRMAN THOMAS: You don't have to direct.

CHAIRMAN ANGELIDES: Okay, for Mr. Thomas, Mr. Thomas needs a break. Five minutes we'll come back with Ms. Born. I'll have some questions. And if any of other commissioners have follow-up questions, we can -- let's make it five minutes, no more than. So run, gentlemen.

(Recess.)

CHAIRMAN ANGELIDES: We will -- the meeting will come back to order. Ms. Born.

COMMISSIONER BORN: Thank you very much.

EXAMINATION BY COMMISSIONER BORN

COMMISSIONER BORN: And thank you both for appearing before us and helping us with these difficult issues.

Mr. Dugan, in your testimony, you point out the different levels of regulations for banks and some shadow banking institutions, and I wanted to ask you about that.

In your view, has the growth of lighter-regulated shadow banks in the shadow banking system created competitive pressures on traditional banking institutions?

MR. DUGAN: Absolutely. I mean, I think in the mortgage crisis, it was a particular example of this. When you had the dramatic increase in mortgages that could be securitized and never touch a regulated institution, you had a big growth in that part of the market.

And the standards that were going on in that kind of market began to influence the standards that our regulated lenders were doing. And that was also true, I might add, even in things like the leveraged lending market, where we were seeing a disconnect between the standards that banks would -- we would hold to if they were holding the loans on their books and the ones that they were selling for distribution to third parties.

And that is precisely why, when I came back to the notion about underwriting standards, it's critical that you can't just apply them to the regulated side. You got to do it across the board.

COMMISSIONER BORN: Are there -- it also raises a question, I think, of whether or not this has put a pressure on the banking regulators to permit the banking institutions they supervise to engage in a greater range of activities.

And we've been told through testimony that, in fact, the semi-repeal of Glass-Steagall by the Gramm-Leach-Bliley Act didn't really change that much because there have been a lot of -- of big range of activities that banking institutions were permitted to engage in. And I wondered if this competition from the unregulated or under-regulated shadow banking system had had some -- played some role in that kind of erosion of the separation between investment banks and banks.

MR. DUGAN: I don't think so much. I mean, I think, over the years, well, let me put it this way. I think that over the years, as markets changed and the kinds of ways that institutions provided credit intermediation services changed and moved more towards standardization, in many ways, began to mean that financial intermediation could be done by investment banks that have -- with clients that previously could only be done by commercial banks.

So the pigeonholed roles began to change as a market mechanism, as you suggest. And then in order for banks, banking organizations, to compete in credit delivery services, they did need to have that greater ability to be in the securities business.

And I think that was a market pressure, it was a real market pressure, and that over time caused legal interpretations and changes to standards and piecemeal adoption by Congress, and finally, it was really more of a ratification, as Mr. Hawke said: The full separate -- full -- full ability to affiliate between commercial banks and investment banks was adopted. So I think it was in response to changes in the marketplace.

COMMISSIONER BORN: Well we, as a Commission, will be looking more deeply into the role of the shadow banking system and the impact it's had on banking regulation and also the role it's played, if any, in the financial crisis. And I hope that we'll be able to, you know, have more interaction with OCC on that --

MR. DUGAN: Sure.

COMMISSIONER BORN: -- as we go forward.

It's occurred to me that, for example, the growth of money market funds must have impacted significantly on commercial banks' deposits.

MR. DUGAN: Absolutely. Yes. That -- no, that, you're absolutely right. There are a number of places that things have come up that have put pressure on the regulated sector that there has been response over the years.

I think one of the interesting things, I wouldn't call them shadow banks, but investment banks were certainly regulated quite differently at a consolidated level than commercial banking organizations were, and I think that did prove to be a problem in the crisis that led -- they were much more highly levered, the problems really started outside in that part of the sphere, and they had more problems dealing with confidence issues.

And the result of the crisis is, of course, the investment -- independent investment banking industry ended, and they either were failed, taken over, or became bank holding companies. And so they're now more inside that same tenet and subject to a more level part of regulation.

But the differences were more of an issue leading up to the crisis than they are now.

COMMISSIONER BORN: Except I think you have indicated that there's still some siloing?

MR. DUGAN: Yes.

COMMISSIONER BORN: With the broker-dealers and, I assume, the FCMs, as well, being primarily supervised and regulated by the SEC and the --

MR. DUGAN: Yeah. And I think that still is an issue, but more I just meant at the holding company as opposed to the functional level.

COMMISSIONER BORN: Do you think there should be a move toward more consolidated standards for regulating the entire structure of the financial institution?

MR. DUGAN: I think you need consolidated supervision of any systemically significant financial institution. I think that's at the heart of the lessons we learned from the crisis, certainly at the heart of the administration's proposal, which I support.

COMMISSIONER BORN: Let me ask in another area, we have heard a lot about the issue of regulatory arbitrage between banking supervisors, the OCC, the OTS, the Fed, the state banking regulators, since, as I understand it, banks have the ability to change their charters, and also OCC, among others, depends on the banking, the fees paid by your banks in order to fund your operations. And I wondered whether there's any validity to this concern.

And I wanted to ask you whether, in your experience, such regulatory arbitrage actually occurs? For example, have you felt pressure to change standards or to permit activities, because another banking supervisor is doing that?

MR. DUGAN: The answer's no. I have not felt such pressure. I do think that on occasion, there have been circumstances where institutions have flipped charters, changed charters in ways that I don't think are appropriate.

I think it's one of the reasons, and this was something I strongly supported, that the banking regulators got together and adopted a document that said you couldn't avoid a supervisory action by switching regulators.

We had something like that. Frankly, there were a number of them where they left the national banking system to go to the state banking system far more than coming the other way.

But in terms of that being a systemic problem, it certainly was not and it has not been. And I have not felt any pressure at all to change as a result of that kind of pressure.

COMMISSIONER BORN: Do you think there's a need to address that issue further?

MR. DUGAN: Well, I think --

COMMISSIONER BORN: Beyond, you know, your suggestion of cooperation?

MR. DUGAN: Well, I testified on regulatory consolidation before, you know, it's -- it's fond of quoting, actually, Jerry Hoffman, the subject where it says it's something that no one would design in theory, but it works okay in practice.

I don't think it was the root cause of a bunch of problems, but on the other hand, could we use some regulatory consolidation; would it be a better system? I think the answer is yes.

But I don't think it's critical that you go to one regulator to address that issue, either as a matter of supervisor efficiency or to avoid the kinds of inappropriate charter arbitrage that you're talking about. There is some talk about doing that -- not some talk, there are proposals to do some regulatory consolidations that are in both; the House-passed bill and the Senate Banking Committee passed version, and I think making progress in that area is appropriate.

MR. HAWKE: Can I just add one point on the question of regulatory arbitrage? And the -- the -- as the Comptroller says, banks convert back and forth all the time. The -- I always gave the mandate to our examiners that they should -- they should be as vigorous as they needed to be to make sure that their banks were operating in a safe and sound manner without regard to the possibility that the bank might decide to convert to another charter.

The OCC has adequate resources to fund its operations without having to worry about -- about individual banks. And I should say that one of the aspects of this dynamic is that the state-chartered banks have a very significant subsidy from the FDIC and the Federal Reserve with respect to their examination costs, because all of the costs of their federal regulation are absorbed by those agencies. So they pay, on average, about half of what national banks pay.

So national banks have, and particularly smaller banks have an incentive to move to state charter to take the benefit of that subsidy.

COMMISSIONER BORN: Thank you very much.

CHAIRMAN ANGELIDES: Mr. Thomas?

EXAMINATION BY VICE CHAIRMAN THOMAS

VICE CHAIRMAN THOMAS: We talked about -- we talked about your brief involvement with Fannie Mae and Freddie Mac, and I don't think we scored the circle, but we just got into it with that discussion when Commissioner Wallison was talking to you about any potential pressure or slanting coming from either Democrat or Republican administration since both of you saddled, and your answer clearly was no.

I would ask you if there was any of that coming from Congress, except I want to put this on the record, as far as Fannie Mae and Freddie Mac, Congress would have no worry because their oversight structure is funded through the appropriations process. And if they don't feel a degree of responsiveness, they have a direct course of action.

You clearly do not, as you indicate, Mr. Hawke, because you get it from the funds of those that you oversee. As a structure, as a degree of independence in terms of decision making or esprit de coeur and the rest, I mean it's got to be, to a certain extent, isn't it, from the way in which you're funded versus OFHEO and Fannie Mae and Freddie Mac living or dying based upon Congress's willingness to offer appropriated funds. Did you feel that when you had that temporary oversight work with Fannie and Freddie, or do you have any comment on that? Because we're going to talk to them tomorrow and I would like a little preview if you have any.

MR. DUGAN: Really, I don't have any. I didn't have any experience with that aspect of it.

VICE CHAIRMAN THOMAS: Well, just let me ask you, if you had your druthers, would you rather have it come out of appropriated funds?

MR. DUGAN: This is what my son refers to as an IQ test, and I'm hoping I'm going to pass. Yes, we --

VICE CHAIRMAN THOMAS: Actually, it's called a pain test rather than IQ.

MR. DUGAN: Well, there's a long history of this, actually, and the regulators were once partly appropriated, some were and some weren't, and the Federal Reserve never was. And it was historically a very important piece of our ability to have and hire -- have the necessary resources and hire the people we need and to have the budget flexibility to maintain our independence with respect to this very highly regulated industry.

And even in those days, it was a -- it has always been the case, it's true of state bank regulators, has been forever funded with the fees, sometimes still went through the appropriations process.

But I believe it is a very important part of our independence to not only be funded through those fees, but not go through the congressional appropriations committee.

VICE CHAIRMAN THOMAS: And then you're only down to the criticism or accusation that Mr. Hawke addressed on the revolving door, that you're the lackeys of the ones who pay your fees, and I would probably rather fight that argument than deal with the appropriations process.

MR. DUGAN: I think that's right. And if you look at the record --

VICE CHAIRMAN THOMAS: Exactly.

MR. DUGAN: -- it's just not that many people who actually -- I mean, there are some, and we have ethics rules we are careful about, and that's all you need to do it.

VICE CHAIRMAN THOMAS: Arm's-length is all you need to do. Thank you, Mr. Chairman.

CHAIRMAN ANGELIDES: Great. So I have a few questions about your oversight of Citi, and then I have a couple of policy questions.

The first is, I think, wonders --

VICE CHAIRMAN THOMAS: Before you start that --

CHAIRMAN ANGELIDES: Oh, I didn't see -- yeah, I didn't see, Mr. Wallison. I'm sorry. I don't always look to my right, Mr. Wallison. It's not a natural for me.

COMMISSIONER WALLISON: I'm always on your right.

CHAIRMAN ANGELIDES: Go ahead, Mr. Wallison.

EXAMINATION BY COMMISSIONER WALLISON

COMMISSIONER WALLISON: I just really had one. One question for Comptroller. You note that the federal standards are very important in preventing predatory lending. And one of the things that we are trying to track down is the degree to which predatory lending was responsible for the poor quality of the mortgages that were in the market.

I know we've made a number of requests to various people who have appeared before us and people who haven't in looking for data on this information on this, on this subject.

And so if -- if your office has any, or know where we can find it, we would appreciate seeing any of that. But I'd like to ask you directly, Comptroller Dugan, how much predatory lending do you see in the course of your work and the work of your examiners and others? How many cases have you had where you've had to bring an enforcement action or counseled an institution about predatory lending? So we can get some sense of how much of this is really going on.

MR. DUGAN: There is a definitional question, of course. There's no single definition of predatory lending. But we took, as an agency -- actually, Mr. Hawke can speak to this even better than I, because it was in a bunch of the early guidance and actions that we took were during his tenure as comptroller.

But we made very clear that predatory lending, whether it was in the mortgage space or the credit card space, was not something we would tolerate; things like loans flipping, equity stripping types of mortgages, the really abusive practices were things we cracked down on. We had to -- we took some enforcement actions in the area, where it was necessary, but honestly, those practices never really took root in the national banking system.

We had more questionable practices in the subprime credit card space. And we did have to take a series of enforcement actions with respect to mono-line subprime credit card lenders to the point where we basically ran them out of the national banking system.

And I do think it's important, however, that there is a distinction between predatory lending and other kinds of subprime lending. And I think, unfortunately, sometimes and particularly as a result of the crisis, people tend to think of all subprime lending as bad and predatory, and that is not the case.

You can also have very poorly underwritten subprime loans that are not predatory, and I think that, in fact, was the heart of the losses that we saw, not -- there are consumer protection problems in some of those as well. There's an important distinction.

We can get to you, for the record, the number of enforcement actions we took for unfair and deceptive practices and provide the guidance that we've provided.

COMMISSIONER WALLISON: And also more than simply the -- the number of enforcement actions?

MR. DUGAN: Correct.

COMMISSIONER WALLISON: But, in fact, rather, the counseling that you've had to done with banks so we can get a sense of how pervasive it is in this large system that you regulate.

MR. DUGAN: Absolutely.

COMMISSIONER WALLISON: Thank you.

MR. HAWKE: Could I just add to that?

COMMISSIONER WALLISON: Sure.

MR. HAWKE: I believe the commission has a document dated February 21, 2003, which was a statement that we put out on -- on predatory lending and where we tried to define it, and we said in that that the OCC did not have reason to believe that national banks or their operating subsidiaries generally engaged in predatory lending practices.

And we had requested both from consumer groups and from state law enforcement people that they inform us of any such examples. And we really got nothing.

Having said that, predatory lending exists, and we -- we -- I know on tours that I have taken in suburban neighbors of Chicago, for example, we've seen evidence of it, and it comes back to a point that I've made several times about the way loans are underwritten.

The essence of predatory lending is making a loan without regard to the borrower's ability to repay, with reliance being placed on the value of the equity in the property, because the predatory lenders have -- are really interested in stripping equity that people have built up in their homes.

And that's why there's such a much higher degree of foreclosures with respect to predatory lending, really, true predatory lending, as I've defined it, than other types of lending.

And that's the reason why we have emphasized, on so many occasion, the importance of underwriting practices that look at a borrower's ability to, through their regular resources to handle the interest and principal payments on loans without regard to the collateral.

If that very fundamental principal of loan underwriting is observed it is a cure for a lot of the bad things that we've seen.

COMMISSIONER WALLISON: Good. Thank you.

CHAIRMAN ANGELIDES: Mr. Georgiou, do you have a quick question?

COMMISSIONER GEORGIOU: Yes, just a quick follow-up on that point.

EXAMINATION BY COMMISSIONER GEORGIOU

COMMISSIONER GEORGIOU: Mr. Hawke, you testified about your guidance that you issued in 2003 in this regard, regarding predatory lending, that they ought not to originate predatory loans, but the OCC never issued any guidance saying national banks shouldn't make loans to firms to facilitate predatory lending.

I mean, I would -- and I guess I would really direct the question, in part, to -- to Mr. Dugan. On page 10 of your testimony, you noted that the 33 billion in the short-term loans provided by national banks to subprime lenders in 2006 called warehouse financing was a small part of all the warehouse financing.

But isn't there a question about whether you ought to have issued guidance with regard to that warehousing; in other words, they may not have originated the predatory loans themselves but they facilitated the origination of the predatory loans by providing warehouse financing to entities that many people regard as having engaged in predatory lending?

MR. HAWKE: We did, Commissioner, on -- on that same date that we put out that other guidance; we put out a statement on avoiding predatory and abusive lending practices in brokered and purchase loans.

And we did address there the need for banks, the national banks, to use diligence when they make or purchase loans that are originated through the mortgage brokers or other intermediaries.

COMMISSIONER GEORGIOU: But make or purchase loans, but what if they didn't, what if they just facilitated, they didn't make them themselves or even purchase them, but they permitted them to be made by providing extensive warehouse financing?

MR. DUGAN: And I think on that point, this is a difficult area, I will acknowledge this, because you don't control the lending of a lender that you lend to, and you don't examine them for their banking practices.

And some people are legitimate subprime lenders and others are not. And it's hard to issue something that says that banks can't make loans to other businesses unless they all abide by the same practices that are required by the banking laws. We never viewed the scope of our things as going quite that far but --

COMMISSIONER GEORGIOU: Understood. Okay. Well, thank you, and if you want to -- if there's anything you want to supplement to us on that --

MR. DUGAN: I would say that, as I noted, my testimony was still quite small percentage of the overall industry that were funded by national bank warehouse loans.

CHAIRMAN ANGELIDES: All right. Let me see if I can run through these, quickly, with your help.

EXAMINATION BY CHAIRMAN ANGELIDES

CHAIRMAN ANGELIDES: Based on your experience, big picture, Citigroup too -- an institution like Citigroup, too big to regulate?

MR. DUGAN: No, I don't think that. I think that the issue is not so much size, as whether the complexity is, and what they're doing prevents risk management challenges, and I don't think they're too big to regulate.

CHAIRMAN ANGELIDES: Any sense?

MR. HAWKE: I -- I -- I agree, we had 45 full time on-site examiners at Citi, and the Fed had another dozen or so, and I -- I think that they -- they were involved in virtually every aspect of the bank's business.

CHAIRMAN ANGELIDES: What about the issue of essentially leakage of their business lines to non-bank entities? Were there very substantial losses?

MR. DUGAN: Well, is it something that can be addressed, is that what you're saying? I think we had some issues that obviously got identified in the crisis. We need to address them. We can address them through better coordination with the other regulators and with the consolidated regulators.

CHAIRMAN ANGELIDES: All right. Second question is, internal risk management, is it a second line of defense or first line of defense? And there's actually an interesting -- it caught my eye because of the wording. There's an OCC staff memo to the file, September 27, 2004, one of the employees, a guy named Bruce Johnson, who wrote, who was on the Citi. I don't know if he was the examiner, the chief examiner.

MR. DUGAN: No, not the examiner.

CHAIRMAN ANGELIDES: Yeah, he did a memo. It was called -- and one of his concerns was called relativity and the boiling frog theory.

I explained that I was concerned that management committees, such as CMAC, which is what we referred to earlier in the day, the committee within Citigroup that approved new products, which are too closely types of products may become too conditioned, not perceived subtle changes over a longer period of time, much like what had happened in real estate in the 1980s.

I explained that occasionally, seeing the most extreme deals to David Bushnell, who was here chief risk officer, and Randy Farmer, who was a good practice, and help them occasionally dip their fingers in the pot to ensure the water was not getting too hot. I guess I would ask you, what's your subsequent internal risk management at Citi?

MR. DUGAN: Well, as I said earlier, it was something where I believed and we believed before the crisis that they were smart, that they generally understood the risks they had, that where we did identify problems, they did respond to those problems. And sometimes we did identify some significant problems.

But it wasn't until the crisis and we saw more pressure put on the system, that it revealed other problems that were more significant as we saw them, in particular the closeness between the risk management and the lines of business.

CHAIRMAN ANGELIDES: And the lines of business, yes.

VICE CHAIRMAN THOMAS: On that point, and this may be an unfair characterization, were they better at selling risk management than performing it?

MR. DUGAN: I can't speak to that, and as I said --

VICE CHAIRMAN THOMAS: Well, it was your impression that they were doing a good job, and it was based on your independent examination?

MR. DUGAN: Yes, at the time -- at the time and that they would respond to things that we were bringing to their attention. They had a bunch of issues. They had a number of things that happened to them that they had to respond to problems. They were under documents in ways that other institutions weren't. We had to keep working through those with them more so than with other institutions.

VICE CHAIRMAN THOMAS: Thank you. Mr. Chairman?

CHAIRMAN ANGELIDES: Yes. So, actually, apropos of that, the OCC had actually issued some warnings to Citi with respect to complex products. And in the course of the run-up, you know, you had noted, I think, in January of `05, that inner earnings and profitability growth were taking precedence over risk management and internal controls.

You had warned that -- I think you had been concerned about the bank's ability to perform future business. I think I would ask you, and let me actually tail onto this, I would ask you, do you think you did -- you identified some problems, I noticed earlier on, about internal controls and their growth. On reflection, and this builds on something I think Ms. Murren and I were talking about, I don't know if it was in public session or a conversation we had, about whether your examinations really were like audits, where there was acidulous follow-up, to make sure all those things were identified, that you stayed on them to make sure that they're correct, do you think -- it looks as though you spotted some problems; maybe you didn't quite understand the depth of what they might become, but do you feel you did an adequate job of following up or do you, on reflection, feel like there should have been more deliberate and consistent follow-up on some of your findings in `05?

MR. DUGAN: No. I believe we followed up quite rigorously on that, we have a quite good system for that where we identify problems, particularly when we identify them in a way that would generate a supervisory letter; we go back to test to make sure that they've complied with that, and so I think what I would say is where the places where we identified and pushed them, they responded. And we made sure they responded. We followed up on that.

They, over the years, had more of those than other companies did, and we needed to -- to do that more than we should have and, as I said during the crisis, some things happened that weren't revealed and that -- that particular examination, that gave us pause in other areas.

CHAIRMAN ANGELIDES: I guess in 2009 there was an inspector general report about two failed institutions OCALA National Bank and first National Bank, in Nevada, where the inspector general, you know, it's always easy to look back, said that, I guess, the problems were spotted early on, and there wasn't formal enforcement action.

Now, there hasn't been an IG report with Citigroup, but you're convinced that you did everything you could to make sure these things, these problems didn't metastasize, that you acted early enough?

MR. DUGAN: You know, I never say that, given all that's happened, that we shouldn't have done more, sooner, with the benefit of hindsight. There are things, definitely, that we perhaps should have leaned harder on them, better reporting around the whole area of contingent problems to the banking institution.

I mean, I'm certainly not going to say we were perfect. I think the kind of thing you pointed out in your report, there, is different, it's a smaller institution, it's a different kind of thought. And we address that separately and you have to take these on their own cases.

And I will say that this institution, as I mentioned earlier, because it came, was put together over a period of time in a quite idiosyncratic way.

CHAIRMAN ANGELIDES: Meaning Citigroup?

MR. DUGAN: Yes, Citigroup.

CHAIRMAN ANGELIDES: There was a set of acquisitions?

MR. DUGAN: Yes, it was a very large investment bank with a very powerful impact on the culture where that was not a traditional commercial banking culture, then that was something that we continually had to deal with, that was different.

CHAIRMAN ANGELIDES: Well, that leads to my next question, but I think you answered it, which is, was the investment bank culture beginning to predominate the state banking.

MR. DUGAN: I would say the answer is yes.

CHAIRMAN ANGELIDES: Hmm?

MR. DUGAN: I would say the answer is yes.

CHAIRMAN ANGELIDES: Okay. Couple more questions, the OTS?

MR. DUGAN: Yes.

CHAIRMAN ANGELIDES: Leakage, arbitrage, how big an issue?

MR. DUGAN: Between?

CHAIRMAN ANGELIDES: For example, Countrywide, didn't Countrywide go from OCC to OTS? Isn't that their path?

MR. DUGAN: You would have to ask -- I -- it was in the wake of our nontraditional mortgage guidance that we were spearheading that they -- it was not long after that or in the context of that that they flipped their charter.

The institution said that they were changing their thoughts and didn't want to be a diversified institution, wanted to concentrate on mortgages, and the OTS was who had more expertise.

CHAIRMAN ANGELIDES: I know you have colleagues but do you think it's a significant issue, charter flipping, potential risk, real and potential?

MR. DUGAN: Well, number one, I think most of the regulatory proposals now have OTS being pulled together in that kind of thought. Number two, I think the significant issue, the thing that we took about people leaving because of regulatory actions also helped address that, so I don't think it's as significant a risk.

CHAIRMAN ANGELIDES: Okay. I took it from your earlier remarks, but I just want to be clear, you thought there should have been national standards on subprime high cost --

MR. DUGAN: Yes.

CHAIRMAN ANGELIDES: -- risky loans? So I take it that you believe the Fed, Federal Reserve, should have adopted much more comprehensive rules under HOEPA?

MR. DUGAN: I think if they would have done that, it would have made a difference.

CHAIRMAN ANGELIDES: Mr. Hawke, do you agree.

MR. HAWKE: Yes.

CHAIRMAN ANGELIDES: Thank you. Final, I think, set of questions, trying to go quickly, members, here.

I want to talk about preemption, because I -- we really haven't touched this today. And I want to touch it because I do think it's worth touching.

In our first hearing, Attorney General Lisa Madigan of Illinois was in the door here testifying before us, and I think you know it's no secret that states all over the country did not agree with your decision to preempt.

MR. DUGAN: That I'm well aware of.

CHAIRMAN ANGELIDES: And I was a state official in California and, while I was not directly involved in those, I followed very closely the legislative efforts in California.

Now, you state that national banks and their subsidiaries, which are both regulated by the OCC, made only 10 percent of all subprime loans made in 2006 was subprime loans being defined as loans with FICO scores 620 or below, people can cut that out of different places, so depending on where you cut it, it can be somewhat higher.

MR. DUGAN: I want to be clear on this. When we had the interview, we talked about this, and we went back and I wanted to make sure we were clear exactly how we got to the number before, how we got to it now; that's not the definition. We could use that definition but that's not the definition.

CHAIRMAN ANGELIDES: It is not?

MR. DUGAN: It is not the definition.

CHAIRMAN ANGELIDES: Thank you very much, we'll -- is there a short definition?

MR. DUGAN: Yes, it's what the -- in our -- in the database is the loan, the premier database, that it's called loan production corporation, I believe, or loan production something, it's for --

CHAIRMAN ANGELIDES: Is it loan performance data?

MR. DUGAN: Loan performance data, okay. Thank you.

A combination of that with our supervisory mortgage metrics that we collect information on and it's all spelled out exactly, but it's basically it's what lenders identify.

CHAIRMAN ANGELIDES: Self-identification?

MR. DUGAN: As prime and subprime.

CHAIRMAN ANGELIDES: Self-identification?

MR. DUGAN: Yes.

CHAIRMAN ANGELIDES: All right. We'll look at the data. But -- but I just want to point out, I mean, in the big picture, here's what some would argue, and I want to put it on the table that you tied the hands of the states and then you sat on your hands.

So Lisa Madigan told us or attorney or General Madigan, I guess is the term to use, first of all, there is this real issue of warehouse lending, and it's not directly related to preemption, but national banks were facilitators. They extended warehouse lines to 21 of the big 25 biggest subprime lenders.

But in terms of at least the data that was provided by Ms. Madigan, which was from the national consumer law center, that when you add up national banks and thrifts, because I think you really have to look at preemption, not just in terms of national banks, but national thrifts, and there's operating subsidiaries, their data shows that I believe in 2006, 31 percent of the subprime, 40.1 percent of the Alt-A, 51 percent of the pay option and ARMs and interest-only adjustable rate loans were made by national banks and thrifts and their subsidiaries, so not inconsequential.

Critics also point out that you only brought 13 consumer-related enforcement actions from 2000 to 2006, and only one of those involved subprime mortgage lending.

Two of the largest subprime lenders weren’t national banks, Countrywide, until they shifted over, and National City, which did its work through First Franklin. So I want to put that on the table.

MR. DUGAN: So --

CHAIRMAN ANGELIDES: And I'd like perhaps both of you, actually, much of this happened under Mr. Hawke.

MR. DUGAN: So let me go first and then --

CHAIRMAN ANGELIDES: Okay.

MR. DUGAN: So in terms of those numbers --

CHAIRMAN ANGELIDES: I'm looking at you and Mr. Hawke, because I want you both to address it, because I think it's a very significant issue, and I would add this; let me just say this. In the end, I would also like you to tell me why you think that the public interests -- because I know it develops, why it was better served, even if it was 10 percent, 20 percent, or 30 percent, was the public interest best served by handcuffing state actions which would have been supplemental to any enforcement actions to the federal government.

VICE CHAIRMAN THOMAS: Mr. Chairman, could we get a brief overview of the point that you're making? But I would very much like to have you take a little time and put it in writing.

MR. DUGAN: Yes.

VICE CHAIRMAN THOMAS: So we have a

better understanding --

MR. DUGAN: Sure.

VICE CHAIRMAN THOMAS: -- of it as we go forward?

MR. DUGAN: I would be happy to do it, as a matter of fact --

CHAIRMAN ANGELIDES: And that is my last question.

MR. DUGAN: Okay.

CHAIRMAN ANGELIDES: Unless you really, unless you trigger five more.

MR. DUGAN: We actually did put it in writing. And it's in my testimony and it's in an appendix.

VICE CHAIRMAN THOMAS: Ahh, okay.

CHAIRMAN ANGELIDES: But I would like you to address it here for public record and public watch.

MR. DUGAN: To the extent I need to supplement it, I certainly will.

CHAIRMAN ANGELIDES: And, again, I believe this was done in your -- when you were comptroller; right, Mr. Hawke?

MR. HAWKE: It has been by all --

CHAIRMAN ANGELIDES: It is mutual responsibility? Okay, good.

MR. DUGAN: So, on the numbers, there are different numbers that have come out, and we wanted to address these because we believed that the numbers that we cited are the best, most accurate, most rigorous, and so the appendix that we attached to the testimony explains in great detail exactly how we got our numbers and why they're different from other numbers, including the numbers you cited in the testimony. So it's in there and we would be happy to respond further if you have further questions.

Let's see, the second question was?

CHAIRMAN ANGELIDES: One is about the numbers, but I think the second and biggest question is, was this in the public interest and why?

MR. DUGAN: Okay.

CHAIRMAN ANGELIDES: And again, going back to whether the number -- again, it didn't include thrifts, but whether it was 10 or 20 or 30 or 40.

MR. DUGAN: So, since we have an appendix in here on why we believe that preemption and uniform national standards is a good thing and has been a good thing; it's been in place since the Presidency of Abraham Lincoln; it's how national banks operate in the banking business, and there is a great value in being able to have a common set of standards that apply regardless of the state in which you operate so that you don't have 50 different sets of rules, 50 different sets of disclosures, 50 different types of enforcement actions brought on different kinds of standards.

We believe that produces more efficient products and services delivered to people. And it's important. Of course, you have to have high consumer standards and consumer protection standards, and we understand that. I think one of the things that the new legislation puts in place, which I support, which is to have a strong federal agency to write consumer protection rules that apply across the board.

But the point is to have a set of uniform national standards, that's always been something that's been viewed as a benefit to the delivery of financial services, products and services to consumers, that's point one.

Second --

CHAIRMAN ANGELIDES: Can I ask you one question on that point one, though?

MR. DUGAN: Yes.

CHAIRMAN ANGELIDES: And that is, and maybe you can address this, was the standard high enough effectively? Was it high enough on reflection, and was the standard high enough in terms of the products which were offered?

MR. DUGAN: And I would say the answer is yes. In some particular areas, that could have been higher, that -- but, generally speaking, I think the answer is yes. I think there are places where we needed higher standards to apply across the board. And let's call it credit card rules, for example, where we did not have that authority.

CHAIRMAN ANGELIDES: But even with default rates that are 86 percent of the market average, that's pretty darn high. It's not that differential.

MR. DUGAN: Well, what I would say is we're going through the worst housing recession in our country's history.

CHAIRMAN ANGELIDES: No, but I'm just being relative. You're saying -- I think what you said was that from `05 to `07, the default rate for national banks for non-prime loans between `05 and `07 was 86 percent of the market average, so give me a breakdown.

MR. DUGAN: What I'm saying there is -- I'm not saying that all the underwriting for those loans was good, I think I said that at the outset, I think there are things that we should have had that were stronger, but I think it's also difficult to trace the differences in the rules between the different persons as how much of that has accounted for it, but the other thing I would say is I don't accept the proposition that the states should spend all their time trying to bring enforcement actions under state law against national banks where you have this huge shadow banking system that's not touched by federal regulations, where you have the biggest problem, and the states are not addressing that issue adequately.

And that's where those resources should be directed, to the shadow banking's system of unregulated people. People say you can't have too many cops on the beat; my answer is, yes, you can, if you don't have an adequate number of cops in total.

We've got people who can monitor the national banking system, and we should be held accountable for it, but the parts where we have problems with the states, we haven't handcuffed the states' ability to go after and deal with problems in the state-regulated state institutions that issue mortgages.

And I think if there were more attention paid to bringing that level of compliance up to what not just national banks but state banks that are also federally regulated are, we'd have a better across-the-board system.

CHAIRMAN ANGELIDES: All right. Mr. Hawke, do you want to comment on this?

MR. HAWKE: I certainly do, Mr. Chairman. First of all, I think it has to be appreciated that preemption is not something we invented or was discretionary with the OCC, it's a constitutional doctrine that has been the law of the land since 1819.

And it basically states a very simple principle, that the states do not have the constitutional authority to regulate or interfere with the activities that Congress has empowered federally created entities to exercise. That -- that -- that has been a doctrine that has carried through our history.

And I think, I'm sure I'm right, that with every preemption issue that has come up, in my knowledge, that has been subject to court review, the courts have upheld that principle.

Congress can change that, if it sees fit, and it could subject federally created entities to state law, but if it hasn't, then I believe that it's our obligation, having taken an oath to defend the Constitution, to -- to enforce the Constitutional principle of preemption.

Second, I -- I think it's very misleading to look at formal enforcement actions as -- as -- as the measure of -- of what an agency's record is in -- in dealing with consumer issues.

And we have -- and the Comptroller's testimony lists a number of formal enforcement actions. But that's the extreme. When a matter gets to a formal enforcement action that -- that -- that reflects a fairly serious conduct.

An enormous number of problems, consumer complaints, are handled every day in the bank examination process. Every time examiners go into a bank if they find a violation of consumer laws, they cite the bank for it, and if the bank doesn't fix it, the regulators come in with an enforcement action.

Besides that, the OCC has what I consider a world class ombudsman's operation that fields literally tens of thousands of communications from consumers every year.

And the ombudsman feeds that back through examiners into the banks. And if there's merit to the complaints that the consumers have raised, we get fixes. We get fixes without a lot of formal action. The fixes get put in place generally with very little formality or other kinds of controversy. If a bank resists and wants to fight about it, then we fight it and it results in a formal enforcement action.

CHAIRMAN ANGELIDES: All right. In the interests of my fellow Commissioner's time, there is one, I think, question that I'll just pose to both of you to be answered in writing. And I just want you to reflect on this.

So here's what struck me about this. I understand, and I do not dismiss, and I appreciate the quality of your answers on this issue, and certainly, you know, the importance of the Constitution.

So -- but when you see, I think, 26 states actively trying to deal with this, because they saw an on-the-ground problem, there's a fascinating article you may or may not have seen from the Columbia Journalism Review about whether or not the press saw the coming financial crisis.

The only reason I mention it is there's a piece of the article that talks about how much press coverage there was from 2002, 2003 as states were actively trying to fight deceptive unfair lending across the country, the boiler rooms, the aggressive lending. I guess I would, in a question, probably posed to both of you, given the ground reality that you have state officials all over the country concerned about the level of unfair deceptive lending, I'm going to ask you both to consider what might have been deficient therefore in national -- in national enforcement that would have led them to believe it was such a para- -- a matter of such paramount concern.

MR. HAWKE: Well, I should say, Mr. Chairman, that we asked state law enforcement officials on many occasions to refer to us any evidence that they had or any incidences they had of national banks involved in conduct of the sort that you described. And we got zero.

And we asked consumer groups for the same thing. We even asked the state attorneys general to enter into a memorandum of understanding with us where we could share information and cross-pollinate on enforcement actions.

And until very recently, with Comptroller Dugan, they refused, they refused to do that, so we did not have -- we did not have evidence emanating from the states or from consumer groups that national banks were --

CHAIRMAN ANGELIDES: Right. And I don't want to cut you off. The full response, in writing, if you could definitely do that for the record. All right, Mr. Thomas?

VICE CHAIRMAN THOMAS: We'll definitely want what, when, written in terms of those contacts that you mentioned, Mr. Hawke, because this is a -- everybody was involved after the fact. I would like a real timeline in terms of who, when, and how.

CHAIRMAN ANGELIDES: Be very helpful. Any other --

VICE CHAIRMAN THOMAS: Thank you for your testimony.

CHAIRMAN ANGELIDES: Any other Commissioners? Hearing none, we'll adjourn today and we will meet here at 9:00 A.M. And just to tell the Commissioners, we will be out of here without fail, tomorrow, at 3:00 because of the travel schedules of several Commissioners. So we will be done prior to 3:00 tomorrow, 9:00 A.M. here in this room. Thank you very, very much for your time, your answers to our questions.

(FCIC Hearing adjourned at 5:28 P.M.)