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Interview with David Gussmann (FNMA) - Reviewed

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MEMORANDUM FOR THE RECORD

Event: Interview with David Gussmann, Fannie Mae

Type of Event: In person interview

Date of Event: Monday, March 31, 2010

Team Leader: Chris Seefer

Location: FCIC small conference room

Participants - Non-Commission:

- David Gussmann
- Mike Walsh, O'Melveny & Myers
- Lauren Strauss, O'Melveny
- Anna Tilton, Fannie Mae

Participants - Commission:

- Chris Seefer
- Carl McCarden
- Al Crego
- Dixie Noonan
- George Wahl
- Sarah Knaus

MFR Prepared by: Sarah Knaus

Date of MFR: August 3, 2010

Summary of the Interview or Submission:

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

Chris Seefer began the interview by explaining that the FCIC was established as part of the Fraud Enforcement and Recovery Act, with the mandate to look at the causes of the financial crisis, specifically, the role of the GSEs. Mr. Gussmann had been identified as someone who could address Fannie Mae's involvement with subprime and Alt-A mortgages.

Seefer: When did you join Fannie Mae and what positions have you held in your tenure? What are you are doing now?

Gussmann: I joined Fannie Mae in February 2007 as VP of Enterprise Management Capital Markets. My division handles the credit risk for the non-agency RMBS book and CMBS book. When I joined, the non-agency RMBS was ___ CMBS was \$25 billion.

Crego: Does CMBS include multifamily?

Gussmann: The tranches we own do get multifamily support, but we do get some others.

Sefer: Has the asset class for multifamily had any meaningful losses compared to others?

Gussmann: Yes. If you look at the collateral performance, CMBS has delinquency rates of 6% and non-CMBS has rates north of 50%.

Sefer: When you joined Fannie Mae in February 2007, who did you report to?

Gussmann: Bill Quinn, who reported to Niculescu. Not Mike or Sandy Quinn. My job responsibilities included covering the credit risk for non-agency RMBS and CMBS. I was responsible for the development of policies and procedures for acquiring and surveying these assets, as well as the return characteristics of these assets.

Sefer: Did you prepare reports to describe the risk characteristics?

Gussmann: Yes, I put together a battery of reports describing the credit worthiness, including Credit Trends Report, Risk Analysis Report, and Exposure Report. These are the regularly produced reports, there are more reports as well. These names might not be accurate.

Sefer: What kind of information did you include in these reports?

Gussmann: The Credit Trends Report would summarize the performance metrics of the underlying collateral of loans. The Risk Analysis Report determines the present value of cash flows of bonds compared to market price. The Exposure Report aggregates our exposure to particular counterparties.

Sefer: For the Credit Trends Reports, what were the metrics?

Gussmann: Prepayments, delinquencies, and later the loss severities, meaning when a loan goes bad how much of the unpaid principal balance is lost.

Stanton: Any forecasting elements?

Gussmann: Not this report. Risk Analysis has a forecast built-in.

Sefer: Risk Analysis?

Gussmann: In summary, it has columns of information, analyses of cash flows, which discount them back to determine price, and then there's a price that's the mark to market which came from other parts of Fannie Mae. The report compares these two prices.

Crego: Are the discount rates static?

Gussmann: They would vary.

Sefer: Was this used for financial reporting?

Gussmann: No.

Sefer: PLS didn't mark to market based on price right?

Gussmann: Yes. There are accounting designations that are on the book. The accounting literature has changed, but I'm not an accountant. There are a variety of literature rules that have applied over the past three years. The most current do present cash flows. This is performed by the finance function of Fannie Mae.

Sefer: Would Risk Analyses go to accounting?

Gussmann: There was a wide distribution, but I'm not sure who it goes to.

Sefer: You have the AOCI, trading book, and eventually here's the OTTI, do you know if those numbers were similar, different, higher, or lower?

Gussmann: I don't know exactly. The answer is that the accounting literature gives different numbers than I used in this document. My numbers should be different than what accounting got because they had different methodology. I don't know the answer, because the discounting methodology is different.

Walsh: We've produced a PLS chart, but if you want the Risk Analysis Reports, shoot me an email.

Stanton: You mentioned a forecasting model, what was forecasted?

Gussmann: Generally, it forecasts the cash flows of the loans that get translated into bond performance.

Stanton: Talk a little about what you did and how well it worked?

Gussmann: There's a basic model that requires a few inputs (what the loan looks like, interest rates, and housing prices). Outputs are generally prepayments, delinquency rates, defaults, and severities.

Stanton: I'm trying to get at how good the model was in terms of how it handled loan characteristics, interest rates and housing prices?

Gussmann: That's difficult answer, because I don't know what good means. We do benchmark our models against other institutional models and compare them.

Stanton: So you came away comfortable about the quality of the models?

Gussmann: Ours are typically in range with other models. They are used to discount cash flow.

Sefer: Risk analysis includes mark to market of securities, were these available?

Gussmann: No. There's a function that's responsible for marking the book, the Independence Price Verification (IPV) group. I think it is Lynda Maggio at the head. The valuation information is put in a database available to many. Vendors also provide prices, sometimes from dealers, at a very high level. We talk to them about where they get the marks from.

Sefer: In mark-to-market, you use a present value using the discount cash flow model. Is this on a security by security basis?

Gussmann: There are totals on there that a viewer could see. The CMDS is managed by a different group, which has an analog in it. Some of the information you're looking for may be in tables in a database somewhere.

Sefer: Do the reports show what the previous values were?

Gussmann: No, there's no trend analysis for the model produced prices.

Sefer: So if we wanted to see the valuations over time we'd have to look at several reports?

Gussmann: Yes.

Sefer: What was your recollection of the values?

Gussmann: That depends on the product type. The values when I got there were close to 100 on the book and probably made a U before the financial crisis as there was no liquidity in the market and prices went, but are now recovering.

Sefer: Understanding it was a loop over time, when do you see declines in values in either mark-to-market or DCS?

Gussmann: I saw some spread widening in 2007. I need to caveat the accuracy of this. In the middle part of 2007 spreads were widening, going from 14 to 30 basis points,

which in dollar prices is very small. At the end of 2007 into 2008 the spreads grew rapidly.

Stanton: When did subprime peak?

Gussmann: Which metric are you talking about?

Stanton: Subprime house prices. If we had a peak in Case-Shiller in 2006, when would the peak of the appreciation be?

Gussmann: They were still appreciating then, but the rate was declining

Walsh: What's a subprime house price?

Stanton: That's a nice question, it's subprime borrower. Subprime is different than the classic Case-Shiller. What was your sense of where house prices for subprime borrowers peaked?

Gussmann: This is something that the BAD group could provide. House prices were still rising for part of 2006, but the rate slowed. It's a question about which derivative. Lots of people view it in different ways.

Stanton: I'm looking at an absolute decline. When you came in and started looking at the book of business, what were you looking at?

Gussmann: The housing prices we looked at were important. I didn't make up my own home price index, there would be no governance over the firm. There's a House Price Index published by BAD.

Stanton: I'm trying to get at the mortgage related securities. The PLS you were dealing with were different from those universal numbers. Who would figure that out?

Gussmann: It's the same Home Price forecast, which is applied to the geography of a certain type. The house price forecast is broken out by zip code, inputted into a model.

Seefer: Was this data put into the model by zip code, loan characteristics, different interest/discount rates?

Gussmann: Discount rates are at a security level, not loan level.

Stanton: It's interest rates for subprime, not whole book?

Gussmann: Not sure what interest rates for subprime you mean. There are a number of interest rates involved in the application, there's a standard Fannie Mae view on forward interest rates.

Seefer: Which rate were you using?

Gussmann: You're asking questions about what the underlying characteristics of the loans are. Whatever characteristics there are, you'd have their information. Fannie Mae publishes its view of different interest rates.

Seefer: Would your risk analysis show the cost base of the securities?

Gussmann: No.

Seefer: Did it show the carrying value was on the publicly reported financial statements?

Gussmann: No.

Seefer: Were you involved in calculated losses on the book?

Gussmann: I was not involved in the actual counting, but my analysis is sent to the accountants who do their calculations.

Seefer: What about your involvement for what needed to be on the trading book?

Gussmann: I'm just a consumer of this information. I would use the accounting process.

Seefer: Who in the accounting department gets this information?

Gussmann: Tom Fay.

Seefer: Who do your reports go to?

Gussmann: They are distributed to the Credit Risk Committee and maybe some other folks. Someone in finance, capital markets, and risk got it. I am in the risk organization now, but was in the capital markets when I arrived. This changed with the arrival of Ken Phelan, post-conservatorship.

Seefer: Looking at the \$125 billion PLS, is there concern?

Gussmann: There's a broader concern about the liquidity of capital markets, and general capital and credit concerns. These discussions involved the capital markets area. There is a financial crisis, so there's a lot of discussions about whether Fannie can fund itself, what are the credit losses going to be, what are the counterparty concerns.

Seefer: Did you always report to Bill Quinn?

Gussmann: Yes, his boss reported to Niculescu, then Dave Benson, and now he reports to Ken Phelan the CRO.

Seefer: Were you ever involved in any discussions regarding the company's reporting of the unrealized losses on the trading book, or if they should be OTTI's versus any other income?

Gussmann: No. I'm not an accountant, they would have discussed them in Finance.

Seefer: So you never looked at the 10-K and said that it looks a whole lot different than my risk analysis report?

Gussmann: This view wouldn't have been one I made looking at the 10-K. I try to stay away from the accounting areas.

Seefer: Were you interested in seeing what the reports were showing, understanding the accounting differences?

Gussmann: Generally, I tried to stay as far away from accounting as I could.

Seefer: When you were doing your valuation through the discount cash flow analysis, did you consider the ABX index?

Gussmann: Yes, there are problems with ABX comparisons to our book. It represents different bonds. The ABX consists of less cash flow bonds, which are more likely to be wiped out than Fannie. Our financials should have a discussion about the difference.

Seefer: Were you involved in the actual acquisitions of PLS?

Gussmann: Most were already done by the time I got there. I had no capital committing authority, but had a reviewing authority.

Seefer: After you got there, were they continuing to purchase securities backed by subprime and Alt-A?

Gussmann: Yes, but the degree declined a lot.

Seefer: My understanding is that the company purchased AAA tranches of PLS backed by subprime and Alt-A, is this accurate?

Gussmann: Yes.

Seefer: Did the company purchase tranches rated lower than AAA?

Gussmann: Yes, they purchased some tranches of AA and A securities through a pilot program that was shut down before limits reached.

Seefer: Why was it shut down?

Gussmann: I don't know the exact dates. Its first purchases were around May or June, with its last purchases around August. It was shut down because there was a concern about the performance of those assets.

Seefer: Did you ever have discussions with OFHEO?

Gussmann: I have definitely had discussions with then-OFHEO.

Seefer: What were the discussions about?

Gussmann: About private label securities. I talked with them probably from the first week until yesterday.

Seefer: Who are you dealing with?

Gussmann: Phil Newman oversees me. There's a reporting structure there. He's a good guy. I had monthly meetings with him, and continuous supervision.

Seefer: When you join Fannie Mae in February 2007, was the pilot program for AA and A tranches already on paper?

Gussmann: It was a goal of the firm when I arrived.

Seefer: I've seen at the beginning of the year, was this one of the goals for board?

Gussmann: Yes. I do think that. I don't know that specific manifestation.

Seefer: Do you know why it took so long to make purchases if it was a goal for 2007?

Gussmann: The firm thought it needed to increase its credit analysis before buying something that wasn't a AAA security. This is based upon an application that my team developed that was then used to analyze the AA and A bonds.

Seefer: Was one of your tasks to develop this application?

Gussmann: Yes, it was a piece of a program to support AA and A.

Seefer: What does that mean?

Gussmann: You understand the model that produces the discounted cash flows, that is the same application as used to analyze the credit riskiness of AA and A.

Seefer: Are you just serving AA and A?

Gussmann: What?

Seefer: How did you develop this? What kind of information did it spit out?

Gussmann: Loan level cash flows and expected cash results. We put scenarios into it and it tells you the bond. Similar to the cash flow.

Stanton: Did I hear right that when you arrived you built the analysis model for the AAAs?

Gussmann: I wouldn't say I built it, there were models existing and we put them together.

Walsh: Did you mean AAA?

Stanton: Yes.

Gussmann: You can use the analysis for any type of bond. The application did not exist, there's a different analysis for AAA securities, which is a scoring of the riskiness of the model.

Stanton: Why would you substitute your model for that?

Gussmann: I'd use it in addition. There's a difference in the investor for the bond for AAA, AA, and A. An investor should do additional analysis for these different tranches. The application can be used on any bond in a deal, you just want to know what the cash flows are.

Stanton: So when the program was shelved for AA and A, what were the implications of that for AAA?

Gussmann: I don't understand. The application existed and we continued to use it.

Seefer: Was this application, the DCF model, used to evaluate the AAA tranches?

Gussmann: Yes.

Seefer: Going back to the pilot program, did Phil know about the pilot program before it was put into affect?

Gussmann: Of course.

Seefer: Was the decision to stop the program a decision by Fannie or were you told to stop by OFHEO?

Gussmann: My recollection is that Fannie stopped it. I think there was a general consensus for a mandate to stop it. Mike Shaw said we're not doing this any more.

Seefer: And the reason was?

Gussmann: The market was deteriorating broadly, meaning less liquidity and credit.

Sefer: Did the company at the same time reduce purchases of AAA tranches?

Gussmann: Yes. The purchase rate declined a lot. At the same time, the request for Fannie to purchase these types of loans increased. Literally, there were billions of dollars of requests for Fannie to take these loans.

Stanton: (shows a document) This was in support of the New Business Initiative, which required communication and signoffs and approval by the Credit Risk Committee.

Gussmann: This is one of the documents, we're good at producing documents.

Sefer: Is there a similar documentation of August to terminate?

Gussmann: The termination was shorter communication. I remember it as an edict from Mike Shaw.

Sefer: Did you talk to Phil about the pilot program?

Gussmann: We had constant discussion about the initiation, the continuation and the termination of the program.

Sefer: Was Phil okay with the program?

Gussmann: He expressed concerns about the program and the capabilities. We put in controls to mitigate his concerns, including application, a cash limit of the program – originally it was \$3 billion, then there was an additional limit around \$750 million. The max amount of the program was \$450 million because of additional controls. Phil was involved in the design of some of the controls.

Sefer: The \$3 billion limit was reduced to \$750?

Gussmann: Yes.

Crego: There was no limit by rating?

Gussmann: There was, an additional limit on A's.

Sefer: Did the company exceed the limit?

Gussmann: Some limits have been exceeded but I don't remember anything being violated. If you're asking me if the \$3 billion was violated, no. The sublimit on AA and A were never violated.

Seefer: These three reports you prepare, are there regular meetings where this is discussed?

Gussmann: Yes. There's the private label advisory team with constituents from different parts of the company, and CRO Shaw had a Credit Risk Committee meeting where we reviewed the portfolio. The PL Advisory meetings now are bi-monthly, can't recall how frequent they were before, but they were regular.

Seefer: Who attends the meetings?

Gussmann: There'd be representation from legal, counterparty, and what was the Capital Markets Mortgage... the traders.

Seefer: Anyone from Risk Office?

Gussmann: I had a peer that reported to Mike Shaw. I would butt heads with the traders would too _____.

Seefer: How many attended the Credit Risk Committee meetings?

Gussmann: I think they were quarterly, wide range of constituents, about 40 people in the room.

Seefer: Did you attend Board Meetings?

Gussmann: No, I never attend board meetings.

Seefer: Before the AA and A pilot program was shut down, did you have any concerns about it or did you recommend it being shut down?

Gussmann: I wasn't against it being shut down, we were declining everything at that time.

Stanton: Because you had created parameters and what was being offered wasn't fitting into the box?

Gussmann: Yes.

Seefer: Was the shutdown a formality?

Gussmann: Yes, a lot of people were trying to dump off bad loans at the time and we were declining those deals.

Seefer: I take it you'd know of any deal that was purchased?

Gussmann: Yes. I would know of any deals purchased post-my arrival, and it wouldn't have been immediately, it took some time to build the procedures, it was several months before we were caught up. I've looked at the deals from before in aggregate. These securities were AAA and they had high levels of subordination. Subprime security would have 25% credit enhancement which means 50% of loans would fail with 50% of the security.

Stanton: _____

Gussmann: There's a senior substructure.

Stanton: What was the relevance of the performance before?

Gussmann: The overall delinquency levels were low through 2007, they were increasing, but not to a level to where you'd get an actual write down on notional principal balance on the bond.

Stanton: Was the value that you were calculating declining before you saw the delinquencies?

Gussmann: Sure. There was a liquidity crisis. There was a hiccup around Bear Stearns, which was the match that set it off.

Seefer: We see a trending up on serious delinquencies on the guarantee book in 2007. Are you seeing the same on the collateral in 2007?

Gussmann: Yes, there is an increase in delinquencies on collateral. The 6-8% and 80% are now, these are the delinquencies of underlying collateral.

Crego: Going back to the risk analysis model, did you do any adjustments for layering of risks?

Gussmann: I saw some of the bonds that had multiple risks layering in the pool.

Crego: Sounds like DLA 2007. Were any adjustments made for cash flows? Maybe one attribute isn't bad, but in combination they weren't performing the same way?

Gussmann: The model does consider the different risk characteristics you're describing.

Crego: What would you do with the cash flows, would they be discounted at a higher rate?

Gussmann: The cash flows that would be produced would consider the riskiness of the loans. The models would produce different cash flows. The performance of that is reviewed.

Crego: Is it reviewed in the cash flow rate?

Gussmann: Indirectly. It may be in the discount rate. The discount rate is based upon the observed price performance on the price of the bond. It's more impacted by price volatility.

Crego: This on average went from 99-100, so in first week of August, 94-95 was big stuff.

Gussmann: The risk analysis report that I'm talking about now would not be available. The report at the time was focused on the write-down. A pending of principal.

Seefer: When did these three reports begin?

Gussmann: Credit Trends were being produced before I joined, but we enhanced it. The risk analysis was not being produced, it's something that we built. The exposure report was being produced.

Seefer: Why was the risk analysis produced?

Gussmann: We didn't have the analytics to support that, they were developed out of the less than AAA products. The company had an extensive battery of watch list criteria.

Seefer: You have mentioned that going into AA and A was part of the goal, what were the goals do you recall in 2008 related to PLS?

Gussmann: In 2008, they become more about loss-mitigation and continued development of timely reporting and surveillance. The company was not continuing to purchase tranches in 2008. Backup, I think there was one bond that was purchased in March 2008, maybe there was a forward commitment.

Stanton: When was the first time either of your two committees discussed these things were not performing as your model predicted?

Gussmann: I can't give you a certain date, but there were discussions about general conditions in 2007, probably right around the Bear Stearns hedge fund blowup.

Stanton: So, up until August 2007 there was no real discussion about the AAA of this program raising concerns?

Gussmann: People were concerned about the market overall, but not that we were taking a write-down on the principal. Fannie Mae is a big organization with 5000 people - you could probably get 5000 different opinions and dates. There were concerns about direction of capital markets.

Stanton: When did you first have a glimmering that this could be really big?

Gussmann: Around Bear Stearns. What is “this”?

Stanton: You tell me.

Gussmann: I did not believe in 2007 that the AAA book would not take any principal price write downs, which is different from price volatility. If you drew a line of the volume, it was probably going down month by month.

EXHIBIT PRESENTATION

Seefer: Does this jog any memory bells? Do you know if Fannie purchased the bond being talked about?

Gussmann: I don't remember this deal, Lehman was a large issuer, but I don't remember a bond with a 400 basis point spread.

Seefer: Were there any discussions about “rogue ___”?

Gussmann: There were a large number of deals that came across my desk that I didn't like in late 2007/2008. Even into the middle of 2007, Fannie had to fight to get deals, because the market was so competitive, but post-Bear Stearns everybody wanted to sell.

Seefer: Did you have veto power?

Gussmann: Yes. People could appeal the veto, but I could say no.

Seefer: Do you recall if Fannie bought any of Lehman's CRE (Commercial Real Estate)?

Gussmann: That would have been a different transaction than what was handled in my domain or knowledge.

Seefer: Do you recall if, once the conservatorship occurred and the Treasury's money came in, did the company's policy of purchasing from the street change?

Gussmann: We weren't buying much then, really since the end of 2007.

Stanton: Which counterparties were selling lower quality stuff?

Gussmann: The model looked at the loan characteristics in a loan tape. Then there's a complex interplay between those cash flows and the bond structure. I was more interested in the overall package if the loan had bond subordination.

Stanton: So counterparty was not a critical variable?

Gussmann: It was, but there's a counterparty group that is responsible for viewing counterparties, there's a list for purchasing counterparties. It was a yes no for some

counterparties. Within the counterparty group there are definitely limits set for different counterparties.

Stanton: When you look back at your PLS now, do you find that certain counterparties sent you stuff that overall did not perform as well as other counterparties?

Gussmann: The non-agency origination had low underwriting and did not have good controls and had lots of fraud. There was disclosure, but it's my belief based upon some current programs to review the loans, that the loans presented were not the loans that were delivered and there was a breakdown in loans and processes in these originators. There was one deal of 3000 loans, where we got into it and looked at the first 50 loans and found someone with 19 mortgages. It was presented that the borrowers just had one loan. We don't have access to the borrower information, they are presented through SEC documentation. We had very strong problems in non-agency originators. Fannie uses a rep and warranty model, and we were able to see a data tape with underwriting guidelines. This is the same for what we got and what everyone else got. The 30% ATV person had 20 properties or something else.

Sefer: This is a problem in terms of reps of the PLS you're buying?

Gussmann: Yes, I'm looking at the representations of warranties and I think it's a high violation. There is a large review program in Single Family, but that is not my expertise.

Sefer: Of the various counterparties, was there one or is there a group that stood out as particularly bad or good?

Gussmann: They all had different niches and characteristics. My belief is that in 2005 and 2007 to compete against Ameriquest or Option One, the worst quality originator sets the level for them.

Sefer: They raise from the bottom?

Gussmann: Yes.

Stanton: Your protection was reps and warranties, and the subordination?

Gussmann: Yes, the protection for the loans being what they say they are is reps and warranties. Some counterparties were cut off, some were never approved, these were done by Counterparty group. Generally, they looked at their balance sheet and operations. It was a review of the counterparty and not securities. Again, this is not my expertise.

Stanton: Assume we hadn't had a really bad market, when would you have recognized the problem?

Gussmann: The true quality doesn't get revealed until a stress situation, and the way the laws are, the information and regulations are dictated by Reg AB which really doesn't give the information needed to examine. We were using SEC registered documents, which was my guarantee.

Stanton: You're saying that Fannie didn't have the market power to say we wanted more information?

Gussmann: It wasn't market power, it was Reg AB. Therefore, we're the same as any other investor in a publically traded security. I'm just like Pimco or Blackrock. They have \$80 billion of this stuff right now. It's different in the Single Family business.

Sefer: So are you guys pursuing anything with these counterparties?

Gussmann: Yes.

Walsh: I have to jump in here. We need to have the conservator in the room for this discussion, and I need to be out of the room for it. I'm conflicted.

Sefer: Do you represent individuals of the management team?

Gussmann: No.

Tilton: When we get into these discussions, O'Melveny has issues with counterparties.

Stanton: Was there a difference looking back into the quality of PLS originations from banks and thrifts versus depositories?

Gussmann: Unfortunately, I don't think there is.

Stanton: But there is significant variation among the top five?

Gussmann: No, I don't think so. Non-agency originations could be tiered, but there was a high level of borrower fraud and a competitive marketplace. Your processes were similar to everyone else's. It's all a high level of fraud.

Sefer: Without naming any counterparties, are you in discussions on counterparties that have at minimum misrepresentations?

Gussmann: I'm bound by a gaggle of –

Tilton: All of this is being directed by FHFA, who has directed to us certain things.

Sefer: I want to know who you're trying to get money back from?

Tilton: We don't discriminate.

Gussmann: We're looking at viable counterparties that sold us stuff.

Stanton: In the PLS you bought, what percent of underlying mortgages were fraudulent?

Gussmann: A really high percentage. Personally, I think there is a very high rate, about 30%. It would be very difficult to say it was anything other than fraud. If I was being very technical, this number could be 50-60%.

Stanton: And that would be investor-owned falsely declared, what's the nature?

Gussmann: Undisclosed debt, undisclosed properties, fraudulent intent to occupy, assets, incomes. If you want to look at causes of housing bubble and crisis, it has to be on your top three. The dumbest person sets the price.

Seefer: *To Dixie Noonan and George Wahl, who just entered the interview.* Mr. Gussmann has been telling us that Fannie is pursuing any counterparty that has mis-repped or included fraud.

Gussmann: We have a program where we are going through a lot of processes to get underlying profiles on the loans. We're working with the trustee to get loan files from a forensic review firm that conducts forensic reviews. What we're finding in there - in the first deal we looked at 50 loans we found someone with 19 properties which are all represented as the only property. Underwriting guidelines didn't let him have multiple properties. We found five misrepresented as a person's only loan. These people are claiming this just to qualify.

Wahl: Are you finding the same actors and same lenders?

Gussmann: I'm offering some opinions. In the deals we look at, if it was a non-agency origination from 2005-2007, the origination quality typical has breakdowns of QC and high level of borrower fraud. It almost doesn't matter which counterparty it is.

Wahl: What do you mean by borrower fraud?

Gussmann: There's some fraud for housing, or where Anna works for me and her job is to fix up houses and I sell her the houses and verify her income. Husbands verifying employment for wives and vice-versa. The most common fraud was that people lied about their incomes.

Wahl: Are you finding that there was no further income verification by lender?

Gussmann: It depends on the product types. Borrower could state income on some, my idea is that you don't get to state a lie. My opinion is that most of the stated income is fraudulent. Depends on Reps and Warranty if you can call it fraud. There is undisclosed

debt, undisclosed mortgages, weird money that varies for payments, lots of income stuff, employment income, assets, credit, intent to occupy.

Wahl: Are you seeing a lot of stuff with verification of deposits?

Gussmann: You see some of that for sure. The bulk is misrepresented income and undisclosed debt.

Sefer: To get an idea of quantifying it without naming counterparties, we know the company had about \$20 billion in Alt-A, subprime and CMBS. What percentage are you trying to recoup?

Gussmann: Our SIV is basically, do we have a viable counterparty and under reps and warrants, are we taking a loss on the book? It's around 40% where some action makes sense. For example, we bought some Lehman stuff and they are no longer around. I'd be looking at everything I think.

Sefer: You think for every PLS you purchased there was some sort of violation?

Gussmann: Yes. It's my opinion.

Sefer: Has the company, contacted every viable counterparty in an effort to get the money back?

Gussmann: We have contacted a fair number of counterparties ranked by potential exposure. The cut off line for reviewing strategy is \$10 million of losses. If there are fewer losses, we won't go after it.

Sefer: Have there been any instances where there wasn't a rep and warranty violation?

Gussmann: No.

Sefer: What is the ballpark of files looked at?

Gussmann: We've looked at probably 10 deals across counterparties, about 1500 loans, about \$4 billion. [There's a difference between the bond and BP. The collateral could be multiplier of bonds. A percent of original collateral.] Typically, I'm going for an adverse example and I'm also not taking every single loan, because the management of it makes sense to go after loans that are delinquent. There are some loans we are not interested in, because they were done so in a ... with a conformed, and a non-conformed tranche. You need to look at the UPB of the collateral and not just the loans.

Sefer: In terms of the face value of the PLS?

Gussmann: Maybe about \$25 billion, maybe about 200 of 600 of Q-sips.

Tilton: You'll want to explain the voting rights too. There's a reason we can't get into all of these deals.

Seefer: So it's driven by a number of considerations: do we have the ability to direct the trustee to do what we want them to do?

Gussmann: Usually we rely on the trustee, and we have to have a certain voting threshold. This changes. We prioritize the deals by where we have voting rights. The strengths of the reps and warrants. We didn't buy PLS without reps and warrants.

Stanton: Were these dictated by the people offering the deal?

Gussmann: The reps and warrants were really driven by the market place. Fannie and all investors were just price takers. If you look at the percentage of the market that we participated in, we own about 4% of the non-agency market. We didn't have market power. The market dictated to us and we were competing with other investors. Investors were fighting for the bonds, not that we could dictate to anybody what was in there. Traders put stipulations on the bonds created for Fannie.

Stanton: Is it possible - I'm interested in understanding better your inability of getting better information?

Gussmann: It's securities law, not an internal memo.

Stanton: At that point in the seller's market, were the deals public?

Gussmann: Generally, they were publically registered deals, 99%.

Stanton: Did you have any difficulty in dealing with trustees? Did you right any type of memo describing the difficulties dealing with them?

Gussmann: I think this is an FHFA in the room type of discussions.

Tilton: I don't know if there is such a document. There are a number of obstacles in my view in a precarious situation with counterparties asking for files.

Stanton: They have to do a lot more work than they were getting paid for?

Gussmann: Yes, and business models dictate who the PLS investors are going after.

Stanton: This is not written down some place?

Gussmann: Not in the form you're looking for.

Seefer: Will you please send us whether it's in a letter or something else, here's what we're doing and obstacles.

Tilton: There's a paragraph in the 10-K.

Sefer: I want more than that. I want to see the various counterparties you are going after. Is there a report?

Gussmann nods yes.

Walsh: I cannot see that report.

Sefer: Okay, then give us a two-page memo of here's what we're doing and the obstacles confronting us. I suspect others are running into these obstacles. Our statute says to look into fraud. I can see a questionnaire or interrogatory asking the big banks about the role of fraud.

Tilton: Please send me an email about this.

Crego: We had some questions about trading book gains and losses for 2009. We wanted to know, of the 3.4 billion gain in the trading book, how much was the gain or loss and the subprime?

Walsh: The company and the accountants are working on the answer.

Gussmann: I wanted to make sure that you understand that the same cash flows used in the Risk Analysis Report are used in the accounting treatments. The same housing prices, same interest rates. GAAP describes the discount rates, FAS 115.

Sefer: Generally, do you know if the values the company is reporting are higher or lower than your Risk Analysis report?

Gussmann: I would think that the values I'm reporting would be lower, because I'm using a higher rate. The only different in the two models will be the discount rate.

Wahl: What was your procedure?

Gussmann: The procedures were dictated in the pulling and servicing agreement. Any party identifying a warranty or breach of representation can make the originating party repurchase the loans. We will put a batch of letters to the Trustee, who then has the role of forcing the repurchases.

Wahl: Do you notify anyone in law enforcement?

Gussmann: No, we notify the Trustee, I don't know what the Trustee's activities would be.

Stanton: Is there a standard trust agreement?

Gussmann: They're all different.

Seefer: Would you reject the deal because you didn't like the trust documents?

Gussmann: Generally we and all other PLS investors were price takers.

Stanton: Can I ask, with your knowledge now, go back to 2005 and you have to participate in this market, how would you protect yourselves better?

Gussmann: Given the current statues, I think that the disclosures would have to change and the version would have to change. There needs to be more transparency about what is being originated and more diligence on these loans.

Stanton: Because you're stuck with the reps and warranties as your protection?

Gussmann: Yes.

Crego: But it goes beyond that. If you buy AAA, shouldn't you have to go buy protection on it?

Gussmann: I agree. Usually you buy protection around B where a buyer will perform more diligence about AAA investors. The further you go down the loans the more diligence the investor would perform. I did not nor did any PLS investor or even B investors have the ability to do more.

Seefer: In general, when Fannie finds instances of fraud, what do they do?

Tilton: We can't see the loan files.

Seefer: Has Fannie filed any suspicious activity reports?

Gussmann: For PLS, no. Ask Nancy Giardini about those in Single Family. We don't own the loans or information.

Seefer: How many trustees are you dealing with?

Gussmann: Six. There aren't that many trustees. We're dealing with six so far and may have up to 10, including: US Bank, Bank of NY, Wells, Deutsche Bank, LaSalle.

Seefer: Who gave you the most frustration so far?

Gussmann: I'm uncomfortable saying that because I have tons of MDAs with these. None of them are really great.

Tilton: Remember, this is David's term of fraud, he's not a lawyer.

Stanton: Was there ever a canary in the coalmine?

Gussmann: Bear Stearns was a signal to everybody. True credit takes years to reveal itself and unless one has access to the documentation files –

Stanton: Fraud is a true credit event, is this true?

Gussmann: I wouldn't disagree that this is a good . . . eristic.

Wahl: How are you identifying these loans as fraudulent?

Gussmann: We direct the trustee to investigate. Typically, the trustee hires a forensics review firm which basically does a re-underwriting of the loan. They re-verify income and employment and reconstruct the borrower's application. Fraud could be a breach, but there's a long list of items of reps and warranties.

Stanton: what you're describing, to what extent do you trust this process to turn up every case you would turn up?

Gussmann: The big obstacle is access to the files. Once the access is achieved, the forensics review firms do a good job.

Stanton: So it's really getting the trustee to take the step?

Gussmann: Another issue is the vertical obstacles in the industry, motivating the counterparties to deliver the files. You have to be extremely persistent on the phone.

Stanton: Do you have more leverage than others?

Gussmann: In some ways, we have more and some ways we have less. At the end of the day I'm relying on the trustee.

Stanton: You don't have a right of action back to the trust?

Gussmann: That goes back to the voting rights. In some cases, we can compel the trustee to do something. In others, it's just me calling them up to look at the documents. We're going to try to mitigate losses wherever we can. The trustees could just take this action themselves if they wanted to. It's just if they wanted to do it.

Seefer: Is the voting right just a percentage issue, or can you call other investors?

Gussmann: There are a number of investor coalitions forming. Ultimately, service providers and legal teams are creating investor-dating services. That would be one several broad activities. The trustee is the administer of the trust. There's only one example, Deutsche Bank is suing the FDIC for misrepresentations in West Bank case.

Stanton: ...

Gussmann: That it's very difficult to get something done by the Trustees. They are taking a lot of steps to ensure that they are not responsible at all. They will take any action that can be supported by a document and nothing that's not supported by a document.

Thank you.

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