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FCIC memo of staff interview with Gary Witt, Temple University

Gary Witt

Brad Bondi

Victor Cunicelli

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MEMORANDUM FOR THE RECORD

Event: Interview of Gary Witt

Type of Event: Phone Interview

Date of Event: May 6, 2010; 3:45 p.m., May 13, 2010; 2:15 p.m.

Team Leader: Brad Bondi

Location: FCIC Offices, 1717 Pennsylvania Ave., Wash., DC

Participants - Non-Commission:

- Gary Witt, Professor Temple University

Participants - Commission:

- Brad Bondi
- Victor Cunicelli

MFR Prepared by: Victor Cunicelli

Date of MFR: May 14, 2010

Summary of the Interview or Submission:

On the above dates and times, reporting investigator (RI) and Deputy General Counsel Brad Bondi interviewed Mr. Gary Witt. Mr. Witt is Assistant Professor of Statistics at Temple University. Mr. Witt was interviewed concerning his former employment at Moody's Investors Service. Mr. Witt said as follows:

While watching the televised PSI hearings the preceding week, he was reminded of something and felt an obligation to disclose it. Richard Michalek reported to him for 18 months while Witt was an MD at Moody's. Michalek was an extremely careful and thorough legal analyst. He liked assigning Michalek to Goldman deals as Goldman deals were extremely complex. ^{36CFR1256.56: Privacy} of Goldman called (Witt's 95% sure it was ^{36CFR1256.5} near the end of 2004 and request Michalek not be assigned any more Goldman deals. ^{36CFR1256} characterized Michalek as "overzealous" complaining his protracted analysis was costing Goldman money. ^{36CFR1256.56} threatened to go over Witt's head if Witt didn't remove Michalek from future Goldman deals. He knew that Michalek had already been spoken to by Moody's President Brian Clarkson about accommodating clients. He was concerned Michalek would be terminated if ^{36CFR1256} went over his head. This was

the only analyst he ever took off a deal at an issuer's request. He did not report the incident up Moody's chain of command as he was concerned for Michalek's future employment. Relationships with investment banks are so "contentious" it was not unusual to remove an analyst.

He found a PowerPoint presentation he gave at a UBS meeting in 2004. He offered to email it to FCIC staff. FCIC staff questioned whether Witt's correlated binomial technique got used for rating CDOs containing RMBS in 2005. He said it was. He wrote papers in or about June and September 2005 explaining how the technique can be employed to normalize a distribution with the CDO-ROM and normal copula methods. Staff advised it was their understanding Witt said his correlated binomial technique was never used for rating CDOs containing RMBS. His August 2004 paper was never used, but his June 2005 paper with new correlation data saw some use. He was interested in updating the outdated binomial expansion technique (BET). BET broke RMBS collateral in CDOs into three categories: prime, subprime, second lien. Second lien correlated more with collateral like credit cards than other mortgage categories, and he was concerned issuers were "abusing" the second lien category. There wasn't a clear definition of what constituted second lien collateral. Moody's left this to the manager to decide. He decided to force issuers to produce information on the second lien category and it turned out his suspicions were correct. He wanted to keep three categories, but wanted them to be: prime, midprime, subprime. He wanted strict FICO distinctions between classes (>625 subprime, 625-700 midprime, <700 prime) so the system "couldn't be gamed." He thought this would make for more diversification of CDOs composed of RMBS (diversification across FICO score). The committee was largely in agreement that issuers were abusing the second lien class. Paul Mazatow wanted to go to two categories (prime/subprime). Witt was concerned this would make the assumptions more conservative, an unintended consequence of his decision. He was extremely concerned a more conservative method could lose Moody's market share and cause him to have to explain the loss to Brian Clarkson. He lobbied Mazatow and got him to concede. In hindsight, he wishes he went with Mazatow's two category (more conservative) method and a 20% vintage penalty for RMBS. Moody's

He was on the rating committee for CDOs. Noel Kirnon was the head of the committee. The committee was composed of roughly 12-15 persons including MDs and senior VPs. The vintage correlation penalty for RMBS (10%) should have been higher like the CMBS (20%) penalty. He never had explicit discussions with Kirnon to arrange assumptions to ensure Moody's would get sufficient market share. Those decisions were made at a high level and all Moody's personnel were aware of the market share implications of using too conservative a set of assumptions. There was a reluctance on the part of management to sign their names to research pieces. Kirnon and Harris were reluctant to put their names on papers he published for Moody's so he could be "scapegoat" in the event an error was detected. People on the rating committee were "careful" not to mention market share when discussing methodology. Moody's personnel commonly said the first job was getting the rating right, but if someone on the committee made a decision which had the effect of diminishing Moody's market share, they'd have

to be able to articulate in a compelling fashion that their decision did not cause the fall or Brian Clarkson would terminate them. Group MDs periodically called in MDs to explain why they did not rate deals.

Kolchinsky wanted to stop rating deals prior to the October 2007 downgrades. Witt corresponded via email to this effect with Andy Kimball in September 2007.

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