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FCIC memo of staff interview with Nestor Dominguez, Citigroup

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MEMORANDUM FOR THE RECORD

Event: Interview with Nestor Dominguez, former Co-Head of Global CDO Business at Citigroup

Type of Event: Group interview

Date of Event: March 2, 2010 at 2:15 p.m.

Team Leader: Brad Bondi

Location: 1285 Avenue of the Americas, New York, NY; Paul Weiss conference room

Participants - Non-Commission:

- Nestor Dominguez, former Citigroup employee
- Mary “Mimi” Reisert, Citigroup counsel
- Linda Imes, Spears & Imes
- Thomas Leith, Spear & Imes
- Susanna Buergel, Paul Weiss
- Jeffrey Newton, Paul Weiss

Participants - Commission:

- Brad Bondi
- Donna Norman
- Karen Dubas

Date of MFR: [ ]

Summary of the Interview or Submission:

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

NORMAN: [Gives standard introduction about creation and purpose of commission, explains 18 U.S.C. 1001]. Can you please state your name for the record?

DOMINGUEZ: Nestor Dominguez.

NORMAN: What was your work experience from 2000 onward?

DOMINGUEZ: I started in the CDO business at Salomon Brothers before we merged with Travelers and then Citi in 1998. I became co-head of the Global CDO Business in 2005 with

Janice Warne. Prior to becoming co-head, I ran the secondary trading desk in the CDO business.

NORMAN: When did you start at Citi?

DOMINGUEZ: I started at Salomon Brothers in February 1993. Before that I was at Bear Stearns for a year, before that I was at First Boston, before that I was at the Federal Reserve, and before that I was at the Brookings Institution.

I have a PhD in economics. I was at Brookings for one year, and I was an economist at the Fed for three years from 1984 to 1987.

NORMAN: Were you at Bear Stearns and First Boston in a trading capacity?

DOMINGUEZ: I got into the business as an academic in a modeling and pricing role at First Boston. In 1994, the business was changing rapidly from a less sophisticated format to a more sophisticated format. At Salomon Brothers I sat next to Marvin Shoals (Black Shoals) for a few years. The way I got into the industry was that I was in charge of the lecture program at the New York Fed, and I met all of the luminaries of modern finance. They were all in New York creating new markets, including securitization. I joined First Boston as a quant and realized that the business side was far more interesting. I transitioned over the years.

NORMAN: What types of products were you involved in as a quant?

DOMINGUEZ: Generically, I was involved in options and options imbedded in mortgage bonds, interest rate derivatives (understanding pricing, caps, floors, etc.), and interest rate and currency swaps.

At First Boston I focused on interest rate products. Over time, as credit derivative markets developed, I started getting involved in those. I started working on CDOs in 1998.

NORMAN: When you started in 1998, who did you work with?

DOMINGUEZ: Geoff Coley ran the corporate and syndicate desks. I think we did one or two deals in 1999. The market at the time was dominated by Morgan Stanley. They were entirely high-yield bonds.

BONDI: By high-yield bonds do you mean junk bonds?

DOMINGUEZ: Yes.

NORMAN: Your position at that point at Salomon Brothers was as a trader on the CDO desk?

DOMINGUEZ: We weren't large enough then to have a separate desk. It was three guys and a Bloomberg sitting on the syndicate desk. We became a desk through an evolutionary process. In

2000 we did maybe three deals, and it became clear that the market was growing and there was institutional investor demand for the product, so we had to designate some people whose primary function was to work on these deals. This was in the 1999 and 2000 time period.

NORMAN: This is a copy of the January 2006 organization chart for Global Structured Credit Products. You're here on the primary desk?

DOMINGUEZ: In 2005, Janice and I became global co-heads, but from 2000 to 2005, that was accurate.

NORMAN: Does this organization chart show how the desk was structured?

DOMINGUEZ: Shalabh Mehrish, Jim Hughes, and Donald Quintin all reported to me. I did everything in the group; I was a secondary trader, and I was the business guy. This chart is really not accurate.

Tim Beaulac did not go to Europe until 2006. Otherwise he was in the structuring group. I'm not sure that Anthony Nahun was still at Citi in 2006.

NORMAN: How many people were on the CDO desk in 2006?

DOMINGUEZ: Twenty sounds like the right number, but I really can't remember. The desk was growing very rapidly. In 2003, it might have been eight guys and a Bloomberg. By 2006, it was probably more than twenty people. The desk grew consistent with the market and the types of CDOs that we did. We did CLOs, ABS CDOs, middle-market trust-preferred CDOs, etc. There were a variety of corporate credit risk products.

NORMAN: What was the relationship between the U.S. and the London CDO desks?

DOMINGUEZ: The London desk was a separate desk that reported into the Credit Derivative business. That was true from the earliest days through the present, as far as I know. I sent Tim Beaulac to London in 2006 to do the cash CDO business—to securitize securities. There was a separate effort that reported directly into Credit Derivatives that did similar deals, but these were synthetic.

Throughout this time, the cash and synthetic deals were converging. Over the years, investors started to look at them as one. Ultimately, the cash and synthetic CDOs were brought together under one house, first under Steve Jones and later under Michael Raynes, who was my boss. I believe that happened into 2005 with Steve Jones, and Michael Raynes replaced him in 2006.

[Mimi Reisert from Citigroup joins the meeting]

The twenty people I was talking about were at the New York cash desk.

NORMAN: As the desks converged in 2005, did the London and New York desks work closely together?

DOMINGUEZ: Yes, I sent Tim Beaulac over there as a senior manager. That started a process of working together that didn't work perfectly. In 2007 Michael Raynes put Mickey Bhatia from New York over the desk in London.

NORMAN: Were all of the pure synthetic deals done out of London?

DOMINGUEZ: They sent some people over to New York who started originating deals from here.

NORMAN: In 2005, who were you reporting to?

DOMINGUEZ: Janice Warne.

NORMAN: What were your responsibilities at that time?

DOMINGUEZ: I ran primary and secondary trading. That means syndicating new issue CDOs and doing secondary trading of seasoned CDOs.

NORMAN: With the ABS CDOs, how did these work?

DOMINGUEZ: Structuring and origination was done by Tim Beaulac, who was also under Janice Warne. To the extent that a deal was being originated, that was more of an investment bank process. There would be conversations between myself and Tim about what investors might be looking for, and we would contact one of the third-party asset managers that we dealt with—these managers typically had proven expertise in managing large pools of asset-backed securities.

Representing the expertise of the manager to the investor was a very important part of the process. We used the well-known managers, like Trust Company of the West, PIMCO, etc. That differentiated our franchise from others because we generally didn't deal with the smaller managers. We would contact the managers, negotiate the terms of the deal, and they would agree to represent the deal to investors.

The deal starts from an investor. We have salesmen who are selling deals to investors on a day-to-day basis. We also have investors who are buyers of CDOs, and the salesmen would go out to them and find out what they are interested in. An investor might say: I would purchase a part of a deal with these characteristics.

I would look for investors who wanted to buy a deal or I'd be trying to sell previously originated deals.

NORMAN: So part of your function was to supervise sales representatives?

DOMINGUEZ: It was not really to supervise, but to throw ideas at them. It's the same process as with any equity or corporate bond deals today.

I would provide color to Tim Beaulac and ask him if those characteristics would work—if there was collateral in the market that would make the economics of this deal work.

NORMAN: Tim Beaulac is who you would go to for advice?

DOMINGUEZ: He was the structuring guy. He and his guys would have their computer models, and they would work with the rating agencies on the structure of the deal. If he came back to me and said that the deal works, we would go to PIMCO and they would agree to manage the deal. PIMCO is a worldwide known name, and they would have access to any of the collateral that they wanted.

PIMCO would go out and purchase specific collateral from somewhere in the marketplace based on the preliminary criteria agreed to with the rating agencies. Their job was to manage the credit in the pool for the benefit of the debt and equity holders. Assuming the terms of the deal worked, we would strike (or close) the deal. That process from the first call to the close might take a year.

The manager could decide to defer when they wanted to start the deal. They would sign an engagement letter that they were interested in the deal, but that they would decide when to start. It might take a year.

NORMAN: Were there placement or incentive fees?

DOMINGUEZ: There were placement fees, but they were the same everywhere.

My view on that was that if you can't produce a product that's attractive to investors, you're not going to sell the product, so it doesn't matter what the placement fees are.

Typically we would open a warehouse facility for the securities.

NORMAN: Was that always true?

DOMINGUEZ: Yes, that was the norm at Citi. The industry would house the deals in the warehouse facilities.

NORMAN: What were the economics of warehousing?

DOMINGUEZ: The average length of warehousing was six to nine months. I would sign a letter authorizing a manager to purchase certain collateral and warehouse it into Citi.

NORMAN: During those six to nine months, Citi would be offering up its balance sheet and financing it all. Is the risk all on Citi?

DOMINGUEZ: We usually try to put the risk back on the asset manager. Typically, those programs have risk-sharing agreements that we tried to make as airtight as possible. What we discovered during the meltdown is that counterparty risk is a very big issue.

As the underwriter, once we started accumulating securities for the deal, we would guarantee the execution of that deal. If it fell apart sometime during those six to nine months, we would take a loss. We had a much longer gestation period.

Every dealer underwrote deals at risk because it was very rare after 1999 to find a deal that was completely sold at the time that it was underwritten.

NORMAN: Let's focus on ABS CDOs unless I specify otherwise. At the end of the six to nine months, once the asset or collateral manager has massed the deal, who prices it?

DOMINGUEZ: What we are pricing are the tranches of the deal. We would juggle the deals, to the extent that we had them, and try to price as close to market as possible. If we couldn't price enough debt, we would lose money.

NORMAN: Who on the syndicate desk would price the deal in 2005?

DOMINGUEZ: Shalabh, myself, and all of the guys who reported to me.

NORMAN: What would you take into consideration?

DOMINGUEZ: We had confirmed-order considerations; we would look at whatever we had. We had already used the models and priced them with the rating agencies.

In a CDO, every piece of collateral is important. You might have a CDO with only thirty pieces in it. CDOs are a credit process; RMBS have thousands of pieces and are an actuarial process.

NORMAN: Is the asset manager in a daily conversation with Tim Beaulac about the assets that are being bought for the deal?

DOMINGUEZ: Yes. Darius Grant would have been the ABS guy in 2005. He would have talked to the rating agencies. There were ten people on that team.

BONDI: Are the ABS CDOs all RMBS, or do they include other types of assets?

DOMINGUEZ: We usually wouldn't have pure residential CDOs—we would put other collateral in there for diversification and because that's what the market wanted.

NORMAN: I mean to talk about primarily RMBS CDOs. And those are the ones that Darius Grant would have worked on?

DOMINGUEZ: Yes, he and others. He would have been the senior person underneath Tim Beaulac to focus on RMBS deals.

NORMAN: In 2005, what was the percentage of deals that were RMBS?

DOMINGUEZ: By the number of deals and by their profitability, it was probably less than 50% of the deals. By volume, it was probably over 50%. The deals tended to be larger, but we did less of them because they had higher fees than other types of deals.

NORMAN: What was the general strategy of the business?

DOMINGUEZ: The strategic initiative was to grow those businesses globally. It was felt that on a risk-return basis, you get higher returns and yields on this market because it's new.

NORMAN: The risk-return conversations within Citi—who was having the conversations about that?

DOMINGUEZ: My points of contact were Geoff Coley and Randy Barker, but it was a long-term conversation, not a conversation at a specific point in time.

BONDI: The CDO business was a money-maker for Citi?

DOMINGUEZ: Yes. We viewed it as good risk, because it capitalized on Citi's strengths: distribution, global presence, balance sheet, and technological innovation and prowess.

NORMAN: What technological innovations are you talking about?

DOMINGUEZ: Citi had all of the parts of the structured credit business to have the ability to put the deals together.

NORMAN: The evolution of the models—was that something that you would do with the rating agencies?

DOMINGUEZ: The way that things usually work with the rating agencies, once they do a deal of a certain type, they can allegedly do it again. When you change the parameters, they would have to change their methodology, because their structure didn't necessarily capture the possible changes with the product. They would have to decide how new products would fit it with their guidelines.

These were rating models—they are structure models used to identify the tranches. These were models for how the CDO could be rated in a certain way and how the tranches would sell. If you were thinking of buying some collateral, you would run it thorough the model to make sure that you weren't violating any percentages.

The collateral manager would identify certain collateral, and the structuring desk would make sure that it didn't violate any of the covenants with the rating agencies or the investors.

The guidance that I would give Jim De Mare is that I would say, "Can you foresee a credit event in the next year?" What the CDO is really worried about is a credit event.

NORMAN: You would get an email back from the secondary desk?

DOMINGUEZ: That's the Jim De Mare desk.

BUERGEL: That's the Global Securitized Markets desk.

BONDI: That's Phil Seares.

BUERGEL: Yes.

DOMINGUEZ: PIMCO would identify a tranche of collateral in the marketplace. We would look at the collateral from the perspective of the CDO and see if that works within the model. If it works, we would contact Jim DeMare and see if that works for him.

NORMAN: You or Darius would send an email to someone in Jim DeMare's group, and what you were worried about was credit risk?

DOMINGUEZ: Yes. What I was worried about was a credit event. We're using PIMCO's judgment to buy the capital—that's what we're marketing to investors. What I want to know is if there's a credit event, like fraud, that we need to be concerned about.

NORMAN: Something like New Century?

DOMINGUEZ: Yes, exactly. Something big.

NORMAN: Over the course of the six to nine months, how frequently would this communication loop happen?

DOMINGUEZ: It probably happened forty to sixty times per deal.

BONDI: I have one question. You would ask your colleague if the label was associated with any fraud. How would he know that?

DOMINGUEZ: The secondary RMBS trader would be in the market and would know about prior fraud or accounting issues. I needed to know that and make sure that PIMCO knew that.

BUERGEL: Was it just fraud, or were there other credit events that you would be concerned about?

DOMINGUEZ: It could be anything, like hearing rumors that a shelf is about to be downgraded, or any event that PIMCO might not be aware of. Usually, PIMCO or TCW were very aware of their collateral and knew more than our traders, but I just wanted to close the loop.

It might not have anything to do with the deal, but we would report credit events when they had something to do with the originator.

BONDI: Did you ever have any conversations with Susan Mills or Dan Hoffman or people at the securitization desk about credit events?

DOMINGUEZ: No. We didn't work with the investment bank; we talked with the secondary trading desk. It was mostly a question of explaining the spread of the originator.

BUERGEL: Susan's group was embedded under the trading desk. She reported to Jim De Mare, and Nestor is talking about going to Jim De Mare (in the same group as Phil Seares).

DOMINGUEZ: The overwhelming majority of the time, they just said that it looked fine to them.

BONDI: How many times did they say not to buy something because of fraud?

DOMINGUEZ: Never.

[Break from 3:20 to 3:30pm]

NORMAN: Did you or anyone in your group have any role in identifying or suggesting particular collateral for the collateral manager?

DOMINGUEZ: Generally speaking, no. But every one of these collateral managers is covered by a Citi salesperson. As the relationship manager and sales point person for PIMCO, he would know that what PIMCO is interested in, and he would show the full lineup of Citi products that PIMCO might be interested in. Yuri in San Francisco is one of those sales representatives, for example. Yuri was aware of the activities of the CDO group.

NORMAN: Can you ballpark how much Citi RMBS ended up in Citi-structured CDOs?

DOMINGUEZ: Less than 20% on average, and many times it would be far less. There is no incentive for the CDO business to favor or disfavor anyone. Our job was to create the best product for investors, because if you didn't that would impede your ability to structure future transactions.

BUERGEL: That's in the chart that I sent you yesterday.

NORMAN: Is there any reason why it would be a small number?

DOMINGUEZ: The Citi ABS securitization business would distribute their deals for the best price, and I always chalked it up to them being very good at their job. My interpretation was that Citi was very good at distributing deals globally. Citi's label traded more tightly than others. PIMCO would be looking for deals with the widest spreads, and that was usually not Citi.

If a deal traded for LIBOR plus-30 versus plus-40, plus-30 would be the tighter deal, which means that it's of a higher quality.

NORMAN: So the market would be assuming that Citi RMBS were less likely to default?

DOMINGUEZ: That's not an assumption. That's a conclusion that the market came to. Higher quality would mean that the RMBS would be less likely to default—it is less risky.

BONDI: So the cash ABS CDOs where RMBS was the predominant underlying collateral were generally lower quality and higher risk than the RMBS that was securitized by Citi? Is that a correct statement?

DOMINGUEZ: Generally, yes, but we're talking about a spread of maybe 5 basis points. That's a handful of basis points.

NORMAN: Did you ever discuss with anyone that Citi's originated product was a low percentage of Citi-CDO make-up?

DOMINGUEZ: I don't recall any specific conversations, but I recall that the RMBS desk would have liked it to be higher. The buying decision was not in our hands though—it was in the collateral manager's hands.

NORMAN: Where did you get the sense that the RMBS desk would like it to be higher?

DOMINGUEZ: It might have been mentioned to me by Jeff Perlowitz or Jim De Mare. My response would have been that PIMCO chooses the collateral, so you should get your salesmen to work harder.

BONDI: Did you ever choose the collateral?

DOMINGUEZ: Only in a couple of transactions. I believe it was pre-2005. The deal was called Jupiter, and it was a static RMBS transaction early on. The whole collateral list was in the offering memorandum.

NORMAN: Did those static deals have a higher percentage of Citi RMBS?

DOMINGUEZ: I don't recall.

NORMAN: Did Jeff Perlowitz or Jim De Mare come to you and ask you to place more of their collateral in CDOs?

DOMINGUEZ: I don't recall. It would have been a water-fountain casual conversation. Every business unit wanted to sell more product so that they could originate more. It was out of our hands—it was in our strict model to have that buying decision in the hands of the collateral manager.

NORMAN: Did you tell Perlowitz or De Mare that their spreads needed to be better?

DOMINGUEZ: That wouldn't have made sense to them. That wasn't in their business practice to widen their spreads. They originate at a certain market.

NORMAN: There was a market for RMBS with wider spreads to go into CDO products that your desk was structuring. Was there any discussion within Citi about how they could participate in that market?

DOMINGUEZ: I don't recall, and again we're talking about 5 basis points.

NORMAN: Were there any discussions of the underwriting standards of the RMBS that you were buying?

DOMINGUEZ: No.

NORMAN: Were there particular levels of underwriting standards at which your desk would not participate?

DOMINGUEZ: No, we only dealt with spreads and prices. When something was spread too wide, that would be flagged for further review to determine why the spreads are so wide.

BONDI: We're trying to determine whether Citi's CDO business was unique, or whether it was typical of CDO desks in other businesses. Do you have a sense of that?

DOMINGUEZ: That's a hard question. I don't have information about other institutions. There's no information that I'd be confident in giving. You saw people's deals in the market, but it's hard to say what went on behind that.

BONDI: Was it typical for other financial institutions not to serve as a collateral manager?

DOMINGUEZ: The typical model was to use a third-party collateral manager. That doesn't mean that there weren't exceptions, and some institutions would have more exceptions than others. We were very strict about using a third-party manager for our deals.

Investors viewed the two types of deals very differently. We just didn't do static deals, because Geoff Coley viewed them as a conflict of interest. A static deal indicates that all of the collateral is in place when the deal goes into the marketplace. It is a closed deal. An institutional investor will re-underwrite the collateral and decide what they want to buy.

NORMAN: After all of the collateral is agreed to in the deal and it's been priced, how does it get distributed?

DOMINGUEZ: It's a very standard distribution process. Institutional investors from hedge funds to insurance companies to other asset management groups will express interest, and we'll tally it up and adjust the spreads to make the tranches more or less attractive. Hopefully the entire deal clears (sells).

NORMAN: Did Citi ever plan to keep parts of the deal?

DOMINGUEZ: On the cash CDO side, we wanted to distribute 100% of the deal. And we were successful with that for about nine years.

NORMAN: What happened to the super-senior tranches?

DOMINGUEZ: There were two types: liquidity puts and super seniors. With the super seniors, we generally sold them either as a cash instrument or with protection from a monoline insurer.

Say we would transact the super senior with the Royal Bank of Scotland. They might buy protection from Ambac or MBIA.

NORMAN: Jumping to the liquidity puts, why did you start doing these? What was your role in them?

DOMINGUEZ: That was done through the credit derivative department, and that book was transferred to the CDO business in the summer of 2005. That book was part of a strategic initiative to increase the structured credit business. Here was product that we felt had *de minimus* risk, but that we felt had a much higher ____. It was a program to put that on the books and create upfront fees for the CDO business.

NORMAN: For the liquidity puts, was Citi in a position to sell the super-senior tranches?

DOMINGUEZ: There was approximately $8 billion of cash super senior—a lot of that production was 2007 production.

NORMAN: Who made the decision to do the liquidity puts?

DOMINGUEZ: I'm not sure that it was any one person. It was a strategic decision that went up very high at Citi, certainly to Tom Maheras's level and above. It would have been through a proposal from the Credit Derivative Business, I think, which would have happened before Steve Jones's time. Rick Caplan and Doug Warren were both gentlemen at my level, and I believe they were both involved in getting that program in place.

BUERGEL: Just to clarify, Tom Maheras was not in his current role at that time.

DOMINGUEZ: I believe it was when he was in the Fixed Income group. This was before he was the head of the investment bank.

BUERGEL: The liquidity puts went through a formal CMAC approval process, and I'll be getting you the memo on that.

NORMAN: The liquidity puts were to generate more business for your desk. Were you involved in that?

DOMINGUEZ: Yes, they were a part of the ABS CDOs that we did.

NORMAN: Was the strategy of the liquidity puts to generate more business for your desk?

DOMINGUEZ: The liquidity put program was never intended to be sold. They were supposed to be kept on Citi's balance sheet indefinitely.

The cash super-senior tranches and the liquidity-put programs were two separate programs. The collateral underlying the liquidity-put programs was higher quality and a generic collateral. The ABCP buyers were very credit conscious, and the program was designed to have the paper roll at attractive rates.

NORMAN: Was the collateral under the liquidity puts of higher quality than that which was underlying the super senior?

DOMINGUEZ: Yes, generally speaking. We had very high quality collateral and got paid very small spreads, but it was very low risk. The return on capital allocated to that asset was very high.

NORMAN: Who was involved in the risk decision that this was relatively low risk?

DOMINGUEZ: It was a number of people over the years.

NORMAN: Was there someone from risk involved in each deal?

DOMINGUEZ: No, but the product program was crafted to certain guidelines and was ratings dependent.

NORMAN: Why did the liquidity put program stop?

DOMINGUEZ: The liquidity put program entails 365-day provisioning by Citi. The Citi Treasury Department felt that the program was getting too big in its absolute size.

BONDI: Who felt that?

DOMINGUEZ: Joe Martinelli certainly, but he wasn't the senior guy. Scott Freidenrich was the treasurer of Capital Markets.

NORMAN: Did you have any involvement in those discussions?

DOMINGUEZ: Yes, he expressed to me and Rick Caplan his concerns, and we did a lot of modeling to see what scenarios would require liquidity to be provided. As it turns out, contingent liquidity was implied in a bunch of vanilla bank products. The firm was aggregating all of those potential contingencies as a Citi-wide assessment of how much has snuck in, and this was one part of it.

NORMAN: Did you have an opinion about that decision?

DOMINGUEZ: Subject to approvals from Scott and others, we would have preferred to continue doing business.

NORMAN: How profitable were the liquidity puts?

DOMINGUEZ: Typically it was 1% up front and 10-20 basis points running. It would be 1% of the notational. On a risk/reward basis, it was felt that this was much better for the bank and its customers. Here you were taking diversified AAA or AA risk, earning a multiple of the fees, and holding less capital under Basel. On a risk/reward basis, that's a much better trade.

NORMAN: Why were other market participants not doing liquidity puts?

DOMINGUEZ: Société Générale and BNP were big players in liquidity puts. It only works if you are a big bank. It's a complicated product and it requires a lot of structuring and expertise. You needed to be a bank with a strong balance sheet, access to collateral, and existing relationships with collateral managers.

NORMAN: Who did the modeling with you?

DOMINGUEZ: Some of the quant guys in my group, DJ Guo (sp?) was one of them. He's in China now. JPMorgan was trying to get into the ABS CDO business, so they kept on hiring guys away from my desk. This was in 2003 or 2004.

NORMAN: How did your quant guys make you comfortable with liquidity puts?

DOMINGUEZ: The collateral in these deals was higher quality—they were generally AA. We created a super senior on top of that. We looked at what the probabilities were of impairment of the cash flows or what the fair spread was on the tranche. All of the models came up with 2 basis points. For a couple of years, we went through numerous modeling exercises and looked at details of events that could impair the credit of these tranches. These situations were incredibly remote. We were doing this in 2005 and 2006. The last liquidity put that we did was in December 2006.

BONDI: You've described the probability of these events happening, but what about their magnitude?

DOMINGUEZ: You have to separate a liquidity event from a credit event. Let's say that the collateral pool was perfect, but say the funding went away because of an interruption in the ABCP.

BONDI: Was it a credit event or a liquidity event that caused the commercial paper to go on the balance sheet to the tune of $25 billion in 2007?

DOMINGUEZ: It was concern in the housing market coupled with a liquidity event.

BONDI: Was the capital benefit of these liquidity puts wiped out when they came back on balance sheet?

DOMINGUEZ: Yes, that's correct. But that might not have been a material number for Citi. Citi had $120 billion of Tier 1 capital. You're taking 8% on the $25 billion, which is about $1.8 billion. In terms of materiality, the corporation has extended credit to that magnitude before. While that was a large move, it certainly wasn't unprecedented.

BONDI: In addition to affecting the capital ratio once you do the haircut through Basel, it also affected Citi's reputation through investors. Isn't that correct?

DOMINGUEZ: Are you talking about shareholders?

BONDI: Yes.

DOMINGUEZ: I'm not sure that's the case. Clearly in October 2007, there were markdowns of that book as a result of the liquidity event. It wasn't just the coming on balance sheet—it was marking them to market.

NORMAN: You mentioned that it wasn't the fact that they came back on the books—it was the downgrades.

BONDI: When the commercial paper came on the books in 2007, how did the investors react?

IMES: Nestor wasn't there after November 1, 2007.

BONDI: Are you a stockholder? What happened to your stock?

DOMINGUEZ: It declined significantly. It was a significant mark-to-market event.

BONDI: Did you personally bear any responsibility for those liquidity puts and the commercial paper coming on the balance sheet?

DOMINGUEZ: It was part of the CDO business and it was part of the legacy book that I inherited when I came to the business, so yes, it was partly my responsibility.

NORMAN: Were there maximum limits on the amount of super-senior tranches that Citi was allowed to retain on its balance sheet?

DOMINGUEZ: There were. Independent Risk set those. Murray Barnes was my direct contact on that.

NORMAN: How frequently did those limits change? How would that happen?

DOMINGUEZ: It typically happened once a year. Usually between December and February, I would put in a limits request, typically for a revision upward because the market was expanding. It was a negotiation of cutting some areas to raise others. It would be based on my judgment of what kinds of deals we would be doing.

NORMAN: Would requests for increased limits be turned down?

DOMINGUEZ: Yes. The dimensionality of the limits matrix was by rating and by asset, and there were sub-limits within the CDO limits related to warehouse-primary versus warehouse-secondary. There was also an overall super-senior unit.

NORMAN: Who was responsible for the hedging of the CDO?

DOMINGUEZ: There were three separate areas where risk was taken. There was warehousing, the primary desk, and the secondary desk. With warehousing, there was no direct hedging, but there were risk-sharing agreements. In the primary business—since that was largely a long book with high turnover—there was no hedging. The secondary book was a market-making and risk-taking book, and individual traders hedged.

NORMAN: The amount that you were warehousing—we looked at the limits book earlier—were there certain limits on your warehousing line?

DOMINGUEZ: Yes.

NORMAN: Earlier in your career at Citi, you did trading on the secondary CDO desk. How did that market develop? What was Citi's role in making a market for secondary CDOs?

DOMINGUEZ: Investors would want liquidity and the ability to sell their positions, so we provided a bid. The big evolution in the Street CDO business was the secondary market. Prior to active participation and market-making, the product was private, opaque, and difficult to get out of, so many investors stayed away from the market. When the secondary market developed, investors felt more comfortable in purchasing CDOs because they knew that they could resell them. That was a catalyst for the CDO market. It was around 2002 and 2003.

NORMAN: Was there an understanding in your deals that Citi would make a secondary market?

DOMINGUEZ: Absolutely. It was the responsibility of any underwriter of any product to provide liquidity for your deal and sometimes for other deals. Market making is a job. Citi took more responsibility for this than some of the other investors.

Dealers who did not make active markets in their deals suffered acceptance by investors. Every major dealer developed a secondary market desk, but some were better than others.

NORMAN: From three guys plus a Bloomberg until your departure from Citi, the CDO desk grew exponentially. What do you attribute that to?

DOMINGUEZ: It grew as the market grew and there was more global demand for the product. As the business grew, you fill in with things like secondary trading that would make a normal market.

NORMAN: What drove Citi's market share increase and made your desk do better than others?

DOMINGUEZ: Citi was a global company, and there were a lot of smart people all over the institution. It was those same elements that I saw working in other successful markets of the institution.

It was normal for me to build upon the strengths of the institution. There was no silver bullet that a single dealer could have brought us. What made the business profitable is that it is hard to put together, and it requires a lot of innate strengths.

NORMAN: You mentioned that the New York desk started doing hybrids. I came across a Bloomberg articles that Citi expanded trading of credit default swaps (CDS) from 2003 to 2006.

DOMINGUEZ: Hybrid deals were a mix of cash, securities, and CDS.

NORMAN: What was the driver of hybrid deals?

DOMINGUEZ: The collateral managers really liked hybrid deals. The CDS swaps allowed you to reference any deal that had ever previously been issued if a dealer was willing to write that derivative. You could diversify across time—you could reference earlier vintages. You were less limited.

NORMAN: They were also much faster, right?

DOMINGUEZ: Yes, there were convenience issues. You could accumulate the collateral very rapidly.

NORMAN: Do you think that the increase in hybrid and synthetic CDOs contributed to the eventual bust of CDOs?

DOMINGUEZ: I don't think so. In fact, I think the contrary would be the case because no new mortgages had to be originated to reference that deal. If you do cash, you have to originate mortgages.

BONDI: These are naked swaps, correct, since you don't own the capital?

DOMINGUEZ: Correct.

BONDI: If there is a failure in one CDS, won't it affect multiple deals? Isn't it a leveraging across the industry?

DOMINGUEZ: It would affect multiple deals, but for every deal where protection is sold, there is an equal and offsetting counterparty who bought protection. The net of the industry is zero. That's the thing about derivatives: we all make right and wrong decisions, and the net is zero.

NORMAN: Why did Citi lose so much?

DOMINGUEZ: It had nothing to do with derivatives; it was all credit risk. We were very reliant on ratings. Fundamentally, the collateral's underlying credit risk was understated. All of these securitization deals were structured to wear some stress. We made assumptions about these securitizations and then we stressed these assumptions. In 99.99% of the cases, there will be no impairment of the interest and principal. The events that happened were far more extreme and severe than any process that Citi or the rating agencies ever could have stressed. That's fundamentally what led to stresses on the business. I don't think that CDSs increased that risk.

NORMAN: When did your desk start repackaging some of the unsold credit tranches?

DOMINGUEZ: Every one of these deals has a bucket in the collateral pool for CDOs. Even though the CDOs are generically RMBS, every deal has some other buckets. Those buckets throughout the industry got larger and larger.

NORMAN: Did there come a time when your desk recycled or repackaged CDOs that did not sell?

DOMINGUEZ: We always offered the asset manager our inventory.

NORMAN: When did you first see weaknesses in the CDO market?

DOMINGUEZ: I saw material weaknesses in summer of 2007. The CDO market has ebbed and flowed since I've worked there. For this cycle, things started to become more severe in summer 2007. I saw problems and weaknesses in the underlying ABS market. In January through March of 2007, we accelerated our purchase of collateral in this RMBS market. We had a number of asset managers call us and tell us to buy things more quickly because the market was cheap. In April 2007, the RMBS market started to rally.

BONDI: In February 2007, didn't Citi decide not to do any more ABS CDOs?

DOMINGUEZ: We decided not to start any new warehouses. We were near our risk limits with warehouses.

BONDI: Did you decide to open new warehouses in April?

DOMINGUEZ: I'm not sure. I don't think so. I think we were still trying to work our way through our inventory.

BONDI: After February 2007, did you open up any new warehouse lines for CDOs?

DOMINGUEZ: I don't think so.

BONDI: What prompted this decision in February 2007?

DOMINGUEZ: HSBC announced some losses, and the RMBS market was sluggish, so as a measure of prudence we decided to slow down. We still bought new collateral, but we decided not to open any new warehouse lines.

BONDI: Are you familiar with the Ridgeway Funding II deal?

DOMINGUEZ: I remember the name. I recall it generically.

BONDI: When was this deal started?

BUERGEL: It closed on June 27, 2007.

DOMINGUEZ: I'm not sure, it would have started around the end of 2006 or early 2007.

I believe there was one TCW transaction that we didn't start, but that grew in size. They were able to buy optimistically, and they decided to do it. TCW is one of the top asset managers.

I believe we did a synthetic deal where we bought protection from Ambac. It was a bespoke trade on the super senior, and that was started late.

BONDI: Do you know who did the first RMBS CDO deal?

DOMINGUEZ: It was Chris Ricciardi at Prudential Based Securities in 2000 or so. He was later at Credit Suisse.

BONDI: Who did the first CDO squared deal that had ties to underlying RMBS?

DOMINGUEZ: I don't know. I don't think it was Citi.

NORMAN: When was the first time that you couldn't distribute the mezzanine tranches?

DOMINGUEZ: That was mid-summer 2007. At that point, we were no longer extending warehouses, but we had deals started. To the extent that these deals had covenants that allowed CDO buckets, we filled those.

NORMAN: Were there any attempts to get out of these?

DOMINGUEZ: It was too late. There were a number of market events, like Russia defaulting and Long Term Capital Management in 1998, that taught us that the loss minimizing strategy was to close your transaction and take your losses on the securitization. The buyers on the tranches were typically long-term investors. So, that was our strategy.

NORMAN: Were you involved in the seven SIVs on the London desk?

DOMINGUEZ: No.

NORMAN: Were you a recipient of the daily Race Report?

DOMINGUEZ: No. Race was a limited distribution. My group reported P&L on a daily basis which fed into the Race Report.

NORMAN: What was your compensation from 2005 to 2007?

DOMINGUEZ: It was about 36 CFR 1256.56 - in 2005 and 36 CFR 1256.56 - in 2006. As more of a senior manager, my salary was 36 CFR 1256.56 - and my compensation was largely in stock, which vested over three years.

The non-salary compensation was on a discretionary basis, which was based on a number of factors including your individual performance, your team's performance your group's performance, and overall Fixed Income performance.

NORMAN: Did you do better when your group made more money?

DOMINGUEZ: Somewhat, it wasn't always linearly linked. I always felt personally that compensation was determined by performance over a long period of time. It would be silly to compensate people for one good year. Geoff and Randy's philosophy focused on franchise and business building over a long period of time.

BONDI: The sales people that you mentioned earlier, how did they get compensated?

DOMINGUEZ: On the sales side, there was an "expected value." It was discretionary. If you did a profitable transaction, you got credited more expected value, and at the end of the year there was a payout ratio that was applied to that expected value. It was nothing close to formulaic.

BONDI: Who was the highest paid salesperson and what was his or her compensation?

DOMINGUEZ: I don't know about compensation. We didn't have a dedicated CDO sales group. We worked through other sales groups in the firm. There was corporate sales, credit sales, mortgage sales, etc. We just borrowed whoever had accounts that understood the product and wanted to get exposure to the product. Christian Holtz, who covered German insurance companies in Frankfurt, was the best salesman.

DJ was the head quant, and he was paid 36 CFR 1256.56 - Privacy The other quants were paid less. It depended somewhat on group performance because when we did well we had more money to give out.

BONDI: How does Citi make money on a typical cash CDO deal?

DOMINGUEZ: This is a generic description of any CDO from any institution at any time. Let's assume that the collateral pool is worth $1 billion. 80-90% of the collateral is typically sourced from other dealers. If you spend $1 billion on collateral in a public RMBS deal, you have to issue more than $1 billion of debt and equity. At close there is a Special Purpose Vehicle (SPV). Citi sends the collateral over to the SPV, and simultaneously the SPV issues $1.01 billion in debt and equity notes to the CDO investors. Typically you earn the $10 million, or about 1% of the collateral. There is slippage on the $10 million with various negotiation aspects of the deal.

The only thing that the warehousing makes is carrying. If their coupon is four and we finance at three, we get to keep the difference. That is the profit from financing.

You would make 20 basis points per year on the commercial paper from the super senior—it was 88%. That's about $2 million on the commercial paper per year if it was $1 billion. On the liquidity puts, the upfront fee was about 1/2 to 3/8 of a percent. The average life was about seven years.

[Break at 5:25 to 5:35]

NORMAN: Can you tell us what this is? CITI 00073991 – Overview of Subprime Exposure

DOMINGUEZ: I believe that this was a presentation to the SEC. They were regular visitors, and desk heads would brief them on different areas. Janice and I put this together to prepare for the June meeting with the SEC on the CSE program.

CITI 7657-7690 is the June version.

I don't remember the June meeting. I did meet with the SEC as a part of the regular process of high-level meetings about the industry. I don't believe I used this presentation—there probably wasn't time for that.

NORMAN: This was prepared for the SEC just for their regular reviews?

DOMINGUEZ: Yes.

NORMAN: Was subprime always a part of that review process?

DOMINGUEZ: It was always an element, but you wouldn't necessarily see the same presentation from June 2006 or 2005. The market had deteriorated significantly, and HSBC had announced some losses.

NORMAN: When did you leave Citi?

DOMINGUEZ: November 1, 2007. That was my termination date, and my final date was January 14, 2008. Chad Leat called me into his office and told me that I couldn't stay. He didn't tell me why, but he didn't have to. We were already making plans to wind down the CDO business. The week before I had been asked to put together a list of 50 people to fire, and I said that I would do that but then I would leave. It obviously had to do with the super-senior problems.

They said that they were going to downsize the business and asked me to put together a list of 50-60 names. By the end of October it was pretty clear that there were some serious issues in the market and that it was not coming back anytime soon. The CDO business had 125 people, covering all assets and locations. Half were involved in corporate loans, trading desk, syndication desk, London, RMBS.

BONDI: Did you receive a severance package?

DOMINGUEZ: I think it was the standard one week for every year of service based on my base salary.

BONDI: Michael Raynes was also terminated?

DOMINGUEZ: Yes, on the same day.

NORMAN: When did you first get the impression that you would have to leave?

DOMINGUEZ: The day I left, but I sort of expected it as the market was trading off in October.

NORMAN: Was Citi holding you accountable for the losses?

DOMINGUEZ: Yes.

BONDI: Was that fair?

DOMINGUEZ: Yes, a portion of the losses were my responsibility, and the portion that I felt was my responsibility was probably large enough for me to be let go. With the liquidity puts, it was a legacy position that I was a part of. The cash CDO books were my responsibility.

NORMAN: Why was Janice Warne not terminated at the same time?

DOMINGUEZ: I was the trading and markets guy. She was the management person. I managed all of the deals, and the traders reported to me.

NORMAN: Who was left standing at Citi's CDO group?

DOMINGUEZ: There was a group of about twenty people who focused entirely on RMBS CDOs, and they let some go in December and kept some on to manage the positions and the deals. They let some go throughout that period. The business shrunk in terms of the opportunities in the global markets.

NORMAN: When you put together the list of whom to terminate, did anything motivate you to pick certain people?

DOMINGUEZ: I chose the least productive members. I put people on the list based on performance. The terminations never actually happened.

BONDI: Were you asked to sign a non-disparagement agreement when you left Citi?

DOMINGUEZ: Yes, I signed it. My understanding was not to disparage any Citi officers or products.

BONDI: Do you regret any decisions you made at Citi?

DOMINGUEZ: I don't think I do. The culture at Citi was one of total integrity. It may have been a large bureaucratic organization, but the people who ran it set an example of dealing fairly. Tom Maheras established that culture. In every instance, people worked very hard to try to do their job as they understood them.

I think it's important to put the losses into context with what the market went through. There was no situation for the market to go down 98%. Under those scenarios, where the market has such extraordinary moves, all of the premises and mathematics that the market is built upon completely break down.

BONDI: Did anyone else make mistakes?

DOMINGUEZ: I'm sure we made our share of mistakes every day. As the business and the markets evolved, and the cash and synthetic markets came together and converged, Citi gained a dominant position. While we started as two separate groups, management made the decision to put the groups together, and that was rare. None of our competitors were able to combine the groups as successfully. That was one of the factors that led us to such a dominant position.

Should we have made changes a month after we noticed problems in the market? Certainly, but it was hard to know at the time.

BONDI: If you were asked to return to Citi to restart the CDO business, what approach would you take to the business and risk management? Is it possible to have a CDO business in the future?

DOMINGUEZ: I just have some general comments. I think that the experience of the market over the last few years has taught us that transparency is critical. If you have transparency, the market will evaluate and price the risk. Without transparency, the market will freeze up. The current problem with securitization is that the market has not reconciled with changes that will improve transparency.

The market for securitization will grow once investors better understand the collateral and trade it more frequently. My recommendation is that there are a number of arcane regulations that should be rationalized so that people don't have to jump through hoops. CDOs should be traded on listed exchanges so they can be processed properly. Until that happens, securitization won't come back, and that includes auto loans and other plain vanilla products.

BONDI: There were some allegations that certain tranches of Citi CDO deals were transferred to London and sold out of there. Do you know of anything about that?

DOMINGUEZ: The market for CDOs is global, and a good part of the investor base is international. It's a market for institutional investors who want exposure to the asset but who don't have the expertise to create the product for themselves. Every deal for every dealer was sold globally.

BONDI: In 2007, when the CDO market in the U.S. started to slow down, was there an attempt to transfer part of inventory from the U.S. to the UK?

DOMINGUEZ: Not at Citi.

BONDI: Did you ever at your tenure at Citi have a conversation about CDOs with Robert Rubin?

DOMINGUEZ: No.

BONDI: Did you ever send Rubin information about CDOs?

DOMINGUEZ: When he first joined Citi, my assistant sent him our Ax sheet (things we had for sale) as a joke, but nothing other than that.

BONDI: Same questions for Mr. Prince

DOMINGUEZ: There was a program at Citi where the senior guys would mentor some of the more junior people. Chuck was my mentor when he was at the investment bank. Twice a year I would go into his office for a fireside chat. He knew that I was in the CDO business, but we didn't talk much about CDOs; we talked about strategy of the business. Our last meeting was just after he became CEO.

We prepared some information in 2007 that we gave to Geoff Coley, Randy Barker, and Chad Leat. I assume some of it was communicated to corporate, but I'm not sure what. I never attended any Board or Board Committee meetings.

BONDI: According to a document, Citi was number six in 2003 in the CDO market. In 2006, they were number one. Were you ever privy to any conversations about growing the business or climbing that list?

DOMINGUEZ: I was involved in conversations about our presence in the CDO market. With the business model at Citi being that of a large global bank, it doesn't make sense to be number six in anything. Being number one, two, and three in terms of volume, profitability, etc. was the business model in every product area.

BONDI: So you kept track of where you were on the list?

DOMINGUEZ: Yes. I kept track of it broadly. There had to be a reason why you were not an industry leader.

BONDI: If Citi had stayed at number six in 2007, would their losses have been less?

DOMINGUEZ: They probably would have been less. The housing market would have still collapsed and Lehman would have still gone bankrupt, but on balance the losses would be lower.

NORMAN: I read that Michael Raynes was brought in to increase CDO volume?

DOMINGUEZ: He was brought in because Citi had felt for years that we did not have the market leadership in the credit derivative area because we did not have the right culture. We needed a "high impact" person (Chad Leat's terms) to "unify" the credit unit. He was brought in to run, manage, and unify the credit derivative business of which CDOs were a part. Deutsche Bank was a market leader.

NORMAN: How did things change when he got there?

DOMINGUEZ: He understood the businesses, and he had the support of all of management. I don't know what practices changed. My desk didn't really change. He really didn't focus on the CDO business—that was a machine that operated well. He spent time on the global businesses, the correlation desk, and the synthetic ABS business.

NORMAN: [Question about competitors]

DOMINGUEZ: When the market has a discrete cliff event like it had in 2007, it's very hard for a large entity like Citi to turn on a dime. In CDO-land, the closest firm to us was Merrill. Goldman didn't have an appreciable business. JPMorgan kept stealing my people but couldn't get their business going. There weren't other appreciable players. We had the best distribution globally. If you accept the premise that you can manage your risk best by distributing it, we were best at that.

NORMAN: Do you think risk management made any mistakes in the CDO area?

DOMINGUEZ: Not really. The risks of the super senior were viewed both mathematically and intuitively as so remote as to be inconceivable.

NORMAN: As an economist, do you think that the math was wrong?

DOMINGUEZ: I think the ratings on the underlying collateral were wrong. An AA tranche was really a B. When you get that type of embedded credit risk that isn't revealed, it passes through the system.

BONDI: Is your perspective on the rating agency models in hindsight, or did you have that opinion at the time?

DOMINGUEZ: That's in hindsight.

BONDI: Did you speak to Bushnell about CDOs?

DOMINGUEZ: No.

BONDI: Did you speak to Bushnell about liquidity puts?

DOMINGUEZ: I was in a meeting with Caplan and Coley in early 2003, and he explained liquidity puts to Dave. He understood that the risk/reward could be advantageous if they were done correctly.

BONDI: What was your interaction with regulators?

DOMINGUEZ: On a regular basis, the OCC and the FRBNY would come by the business. There were various reviews that the OCC conducted, and our internal audit department would report to the OCC.

BONDI: What were the OCC's operational concerns?

DOMINGUEZ: In 2002 and 2003, they had concerns about some unsigned ____.

BUERGEL: I'm sorry, but this is privileged by the OCC. You'll have to go to both the OCC and the Fed and ask them to waive their privilege. That's the subject of some of the redactions that you've asked questions about.

BONDI: From January 1, 2006 to June 2007, did any regulator express any concern with respect to anything related to the CDO business at Citi?

DOMINGUEZ: Not to my knowledge and not to me. In December of 2006, we had a very extensive internal audit.

BUERGEL: This was Joe Forlenza's report that you have.

DOMINGUEZ: It was a very extensive whole business audit that gets reported to the various regulators. We prided ourselves on running a tight ship.

IMES: Just to clarify, there is nothing in your non-disparagement terms that would stop you from giving truthful answers, right?

DOMINGUEZ: No, not at all.

NORMAN: Have you ever given testimony before?

DOMINGUEZ: No.

NORMAN: Where are you now?

DOMINGUEZ: I work at Carlson Capital. I'm an investment manager.

BONDI: Have you ever been interviewed by the SEC on matters related to enforcement actions?

DOMINGUEZ: No.

NORMAN: Please keep this confidential.

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