Testimony of David Bushnell
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Financial Crisis Inquiry Commission
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Chairman Angelides, Vice Chairman Thomas, and Members of the Commission, I am pleased to participate in today's hearing and to assist in your important and challenging inquiry. My name is David Bushnell, and I was the Chief Risk Officer of Citigroup from 2003 to 2007 and Chief Administrative Officer of Citigroup in the latter part of 2007.

I would like to begin my testimony today by addressing what is, in my view, the single-most important contributing factor to Citi's significant write-downs and losses.

As you know, beginning in 2007, an unprecedented collapse in United States residential real estate was the primary instigator of a global crisis in the world's financial systems. As with many other market participants, Citi was severely impacted by this sudden economic downturn. In particular, Citi suffered massive unanticipated losses in connection with its approximately $43 billion position in a specific asset class exposed to subprime residential real estate. These were the so called "super senior" tranches of CDOs collateralized in part by subprime-related securities. In the fourth quarter of 2007 alone, Citi took a $14.3 billion write-down on this single asset class.

These super-senior CDO tranches have since come under tremendous scrutiny, and rightfully so. To understand their contribution to the losses, however, it is important to understand how these investments were perceived at the time. First, in 2007 this $43 billion position represented less than 2% of Citi's $2.3 trillion balance sheet. Second, prior to late 2007, these securities were rated above-AAA—an extremely high

credit rating. Citi and the rest of the market shared the view that super seniors were safe, and presented an extremely low risk of default or depreciation in value. Third, the views of the credit rating agencies were reinforced, in part, by risk models employed by Citi. These risk models, like those of most major financial institutions, tested for what were believed to be extreme loss scenarios for residential real estate. We now know that even the most pessimistic assumptions in these models did not foresee the severity of the downturn.

Clearly, Citi and virtually all other market participants failed to anticipate the dramatic and unprecedented decline in the housing market that occurred in 2007 and 2008. Risk models, which primarily use history as their guide, assumed that any annual decline in real estate values would not exceed the worst case historical precedent. And since the beginning of World War II, nominal home prices in the United States had never decreased by more than five percent in any given year. The actual decline proved to be many orders of magnitude greater than any other yearly decline in the post-war period.

As the Chief Risk Officer during the relevant period, I have given a great deal of thought to these events. With the benefit of hindsight, there are several key "lessons learned" from a risk management perspective. First, the write-downs associated with Citi's CDO positions far exceeded anything predicted by our stress tests, and were materially greater than was anticipated using a statistical approach. These unprecedented market events have reinforced the lesson that, in extreme market conditions, traditional stress tests and a purely statistical approach may not fully describe the risk. Second, the complexity and sophistication of these structured products obscured the importance of understanding the risk characteristics of the ultimate underlying collateral, that is,

residential mortgages. At the time, risk modeling of these securities—at Citi, other financial institutions, and the rating agencies—was not designed to consider loan-level information. At the most basic level, Citi did not contemplate the possibility of an unprecedented, across-the-board, nation-wide collapse in real estate prices. Neither did other market participants nor our regulators, but that does not relieve the consequences for Citi. Third, at the most sophisticated level, none of us fully appreciated the consequences such a collapse would have for even the senior-most rated tranches of these structured products. Nor did any market participants engage in full underwriting review of the portions of these investments that they determined to hold. In short, we did not anticipate these extraordinary developments or comprehend these interconnections, and we made a rational, but in retrospect mistaken, business judgment to retain the super-senior tranches of the CDOs. Citi's multi-billion-dollar losses in late 2007 were the product of those judgments.

As Chief Risk Officer, I was responsible for communicating risk and compliance issues to Executive Management, the Board of Directors, and external regulators. I communicated almost daily on an ad hoc basis with the CEO, Chuck Prince, and had a regular, weekly one-on-one meeting with him. I was also a member of and attended weekly Citigroup Business Heads meetings with all of the senior-most executives from the firm's businesses and various administrative and control functions. I provided regular risk reports to the full Board of Directors and participated in Audit and Risk Management Committee and Subcommittee meetings.

The Independent Risk organization was organized across business lines with a geographic overlay. By this I mean there were risk reporting lines within each of

the major Citi business units and at the holding company level, as well as within the geographic regions where Citi does business. All of these reported up to me, through a chain of increasingly senior risk managers, in order to assure their independence. In all, I oversaw a risk organization of approximately 2700 highly qualified risk professionals.

Citi's risk discipline framework, all of which was highly documented and subjected to audits, was organized around four forms of risk: credit risk, market risk, liquidity risk, and operational risk. To monitor and evaluate these risks, Independent Risk employed robust risk management tools. These included risk limits, portfolio management, risk capital, VAR and stress testing for what we then considered extreme loss scenarios. All of these procedures were well known to our regulators and were conducted in accordance with the then global banking capital regulatory standards. All extensions of credit required the approval of risk management. Likewise, risk limits were set by risk managers and could not be increased or otherwise modified without the approval of our risk group. If there was a disagreement between our risk group and the business as to the appropriate limit, Independent Risk had the final say.

I would like to conclude by noting Citi's risk managers were dedicated, well-trained professionals, with the independence, authority, tools and technology to deliver best-in-class risk oversight. That does not change the fact that in this case, our method of analysis was not good enough. I hope that my participation in this hearing will contribute in some small way to the important work of the Commission, to better protect the financial system in the future.

I will be happy to answer any of your questions.

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