

## STATEMENT OF FACTS

In 2006 and 2007, Citigroup Inc., through certain of its affiliates (“Citigroup”), securitized thousands of residential mortgage loans and sold the resulting residential mortgage-backed securities (“RMBS”) for tens of billions of dollars to investors, including federally-insured financial institutions. Prior to securitization, Citigroup conducted due diligence on loans (including credit, compliance, and valuation due diligence). In securitizing and issuing the RMBS, Citigroup provided representations in offering documents about the characteristics of the underlying loans. As described below, in the due diligence process, Citigroup received information indicating that, for certain loan pools, significant percentages of the loans reviewed did not conform to the representations provided to investors about the pools of loans to be securitized.

### **Citigroup’s RMBS securitization process and representations**

In 2006 and 2007, Citigroup securitized and sold RMBS, through both “third-party” and “principal” transactions.

For “third-party” transactions, Citigroup served as an underwriter. In certain of those transactions, Citigroup served as the lead underwriter. In that role, Citigroup, among other things, structured the transaction and sold RMBS certificates to investors. Citigroup acted as an underwriter through its wholly-owned subsidiary Citigroup Global Markets Inc.

For “principal” transactions, Citigroup purchased groups or “pools” of loans from third parties prior to securitization and, in certain instances, originated the loans itself through another of its subsidiaries. Citigroup also acted as underwriter for certain of the principal transactions. Citigroup bought pools of mortgage loans from numerous lending institutions, or “originators.” These lending institutions included Ameriquest Mortgage Company, Argent Mortgage Company LLC, Accredited Home Lenders, Inc., Countrywide Home Loans, Inc., New Century Mortgage Corporation, Wells Fargo Bank, N.A., and others.

In these transactions, Citigroup securitized the loans under its own shelf registration, such as its shelf known as “Citigroup Mortgage Loan Trust Inc.” or “CMLTI.”

In various RMBS offerings, Citigroup provided representations, or otherwise disclosed information, in certain offering documents, about the loans it securitized, telling investors that:

- Loans in the securitized pools were originated generally in accordance with the loan originator’s underwriting guidelines.
- Exceptions to those underwriting guidelines had been made when the originator identified “compensating factors” at the time of origination.
- The securitization sponsor or originator (which, in certain instances, was Citigroup) represented that each loan had been originated in compliance with federal, state, and local laws and regulations.
- The loans being securitized had various characteristics, such as loan-to-value ratios at origination within various ranges.

In the base prospectus for certain RMBS offerings, Citigroup further represented that it would not include any loan “if anything has come to [Citigroup’s] attention that would cause it to believe that the representations and warranties made in respect of such mortgage loan will not be accurate and complete in all material respects as of the date of initial issuance of the related series of securities.”

### **Citigroup’s due diligence process**

Citigroup reviewed due diligence results on loans prior to securitization.

In principal transactions, before purchasing a pool of loans from a third-party originator, Citigroup conducted due diligence on those loans.

Citigroup typically conducted this due diligence by reviewing certain loans in the loan pool, rather than the entire pool. This sample was generally composed of certain loans from the pool with characteristics that Citigroup viewed as warranting review. Citigroup would contract with a due diligence vendor to review the sampled loans. The vendor would “re-underwrite” the individual loan files in the sample.

Part of this review focused on “credit,” including whether the loan met the originator’s underwriting guidelines, or whether the originator had found the loan to possess sufficient “compensating factors” to warrant a deviation from the guidelines. Another part of this review was focused on “compliance,” to determine whether the loan had been originated in compliance with federal, state, and local laws and regulations.

For each sampled loan reviewed for “credit” and “compliance,” the due diligence vendor assigned a grade. In general, the vendor graded a loan “EV1” when the loan was underwritten according to the applicable guidelines and originated in compliance with applicable laws. The vendor generally graded a loan as “EV2” when the loan did not comply with applicable underwriting guidelines, but nonetheless had sufficient compensating factors that the originator had found to justify the extension of credit. The vendor graded a loan “EV3” when the loan was not originated in compliance with applicable laws and regulations, the loan did not comply with applicable underwriting guidelines and lacked the sufficient offsetting compensating factors, or the loan file was missing a key piece of documentation.

Citigroup obtained the results of the credit and compliance reviews from the due diligence vendors and was provided information about the number or percentage of loans in the sample that the vendor had graded EV3. Citigroup also was provided with the reasons that the vendor had assigned the EV3 grades, including the nature of the defects, such as

whether the borrower had unreasonable stated income, when the borrower's credit score was below guidelines, when the ratios of loan-to-property value and debt-to-income exceeded the underwriting guidelines, and when the loan file reviewed was missing documents or had inadequate documentation. Citigroup referred to EV3 loans as “kicks,” “kickouts,” or “rejects.”

Citigroup also used a due diligence process to assess the reported values of the properties that served as collateral for the mortgage loans. This “valuation” review was intended to determine whether information about the property’s value sufficiently supported the reported value for the property. The valuation review was conducted by a vendor, using methods such as automated valuation models, broker price opinions, and appraisal reviews. The vendor used one or more of these methods to calculate a valuation determination for the property being reviewed.

Citigroup used thresholds or “tolerances” for the valuation firm to assess whether the information about the property’s value sufficiently supported the reported value as determined by an appraiser. Citigroup instructed the vendor to recommend the loan for rejection if the vendor’s valuation determination differed from the appraised value by more than 15 percent with respect to certain types of loans. In other words, Citigroup had an internal “tolerance” of up to 15 percent. This meant that Citigroup routinely accepted, for purposes of the valuation review, specific types of loans for purchase and securitization when the valuation firm’s determination deviated by less than 15 percent from the reported appraised value. Citigroup’s thresholds further provided that if a valuation firm determined that the combined loan-to-value ratio for a loan exceeded 100 percent, the loan would be recommended for rejection.

In third-party transactions, depending on the role played by Citigroup, Citigroup would work with due diligence vendors to perform diligence on samples of loans selected with

the participation of the issuer or otherwise review reports from due diligence vendors retained by the issuer or other underwriters to the transaction.

### **Due diligence on Citigroup RMBS in 2006 and 2007**

In 2006 and 2007, Citigroup's due diligence vendors provided Citigroup with reports reflecting that the vendors had graded certain of the sampled loans as EV3. For numerous pools, the reports showed that the vendors had graded significant percentages of the sampled loans as EV3.<sup>1</sup>

In addition, Citigroup's internal due diligence personnel reevaluated loan grades and subsequently directed the due diligence vendor to assign grades of EV1 or EV2 to loans as to which Citigroup's due diligence vendors had previously assigned grades of EV3. Certain of Citigroup's main due diligence vendors would track when loans that they had graded as EV3 were "waived" in by Citigroup. Citigroup's contemporaneous records did not in all cases document Citigroup's reasons for directing the due diligence vendors to re-grade loans.

Further, in certain instances, Citigroup learned from the vendors conducting valuation due diligence that loans in particular loan pools exceeded Citigroup's valuation tolerances. The vendors also reported that a number of the properties securing the loans had reported or appraised values that were higher than the vendors' valuation determination. In certain instances, Citigroup securitized loans that its vendors had reported exceeded Citigroup's valuation tolerances or where the vendor's valuation determination exceeded the reported or appraised value.

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<sup>1</sup> There were loans in each of the RMBS reviewed by the Justice Department that did not comply with underwriting guidelines, including the securitizations set forth on Appendix 1, which the Justice Department determined to contain significant percentages of defective loans.

## **Examples**

In the following deals, Citigroup securitized loans, making representations of the type described earlier that the loans generally complied with underwriting guidelines or had sufficient compensating factors, had been originated in compliance with law, and possessed certain characteristics.

1. In three CMLTI RMBS issued and underwritten by Citigroup in 2006, Citigroup's due diligence vendors reported to Citigroup their findings that loans in the samples had not been originated in compliance with underwriting guidelines and with applicable federal law and regulations. Certain of these loans were missing documentation, such as HUD-1 documents that Citigroup had told the vendor were necessary. A due diligence report sent to Citigroup, after the re-underwriting was complete, showed that more than 12 percent of loans in the sample had been graded EV3. A due diligence report for another large pool, which contributed over 2,000 loans to another RMBS, showed that more than 29 percent of the sampled loans had been graded EV3. Citigroup securitized the loans from these pools that had not been rejected at the end of the due diligence process in the three RMBS.

2. In an RMBS where Citigroup served as the lead underwriter in 2006, the due diligence report provided to Citigroup by its vendor showed that more than 25 percent of the loans in the sample reviewed for credit and compliance had been graded by the vendor as EV3 or were found to have missing file documents. Many of the loans did not comply with underwriting guidelines or represented exceptions to those guidelines: more than 67 percent were graded as EV2 by the vendor. The vendor graded only approximately 6 percent of the loans in the sample as EV1. Notwithstanding these results, Citigroup securitized loans from this pool in the RMBS.

3. In a CMLTI RMBS issued and underwritten by Citigroup in 2007, the due diligence vendor initially reviewed a sample of loans selected based on certain criteria (the

“adverse sample”). Early in the diligence process, the vendor notified Citigroup employees that it had graded over 44 percent of the adverse sample as EV3s. The vendor identified trends associated with its review of those loans and stated that, if the trends continued, it expected the pool to have an “unusually large” number and percentage of rejects.

Later in the due diligence process, the vendor asked Citigroup whether it would be “prudent” to perform additional diligence based on a random sample, to determine whether the large number of “kick outs” were the result of the adverse selection method or reflective of the loans across the entire pool. Thereafter, the due diligence vendor advised Citigroup that it had graded over 32 percent of the random sample as EV3.

In addition, during the due diligence on the same loan pool, Citigroup’s due diligence personnel reevaluated certain of the vendor’s loan grades and directed the due diligence vendor to change some of those grades from an EV3 to an EV2 or EV1. The final report from the vendor graded approximately 20 percent of the sample as EV3.

Apart from the random sample, Citigroup did not conduct further due diligence to determine whether the remaining loans in the pool contained defects. Instead, Citigroup securitized loans from this pool in the RMBS.

4. In two CMLTI RMBS issued and underwritten by Citigroup in 2007, Citigroup’s due diligence vendor identified a number of loans that were outside of Citigroup’s valuation rules and tolerances. These included loans where the difference between the reported original appraisal and the vendor’s valuation determination exceeded 15 percent, or otherwise exceeded Citigroup’s thresholds. Citigroup also instructed the due diligence vendor to change the grades of loans that its vendor had recommended for rejection, following Citigroup’s review of those loans and loan grades. Citigroup then securitized hundreds of the loans that its vendor had identified as outside of Citigroup’s tolerances.

In addition, early in the due diligence process, a trader at Citigroup wrote an internal email that indicated that he had reviewed a due diligence report summarizing loans that the due diligence vendor had graded as EV3s and had noted that “a lot” of these rejected loans had unreasonable income and values below the original appraisal, which resulted in combined loan- to-value in excess of 100 percent. The trader stated that he “went thru the Diligence Reports and think that we should start praying... I would not be surprised if half of these loans went down. There are a lot of loans that have unreasonable incomes, values below the original appraisals (CLTV would be >100), etc. It’s amazing that some of these loans were closed at all.”

Despite this trader’s observations, Citigroup securitized loans from this pool in the two RMBS.

5. In four CMLTI RMBS issued and underwritten by Citigroup in 2007, Citigroup securitized loans from two loan sellers. Citigroup employees had been informed that in prior RMBS securitizations where the underlying loans were from the same companies, a significant number of loans had already gone into early default.

In addition, prior to the securitization of those four RMBS, Citigroup received additional information about the quality of mortgage underwriting at those companies. Prior to the issuance of the four RMBS in 2007, Citigroup had begun the process to acquire assets from one of the companies. As part of that acquisition, Citigroup conducted due diligence on the companies. As part of that due diligence, Citigroup received some of the company’s internal audit reports, and distributed them to, among others, a Managing Director who was involved with Citigroup’s RMBS securitizations. The internal audit reports showed that the seller had itself found, in the prior year, that it lacked key internal controls over its quality assurance for loan production, and that substantial percentages of the loans failed to adhere to underwriting guidelines, which the seller itself labelled as “high risk.”



Citigroup also conducted its own reviews of a sample of loans provided by the seller. In that process, Citigroup identified issues with the seller's internal quality controls.

During this time, Citigroup's due diligence vendors graded a number of sampled loans, both from loan pools to be securitized and from loans funded through "warehouse" lines of credit, as EV3, including loans that the vendors found did not comply with applicable laws and regulations due to missing documentation. In certain instances, Citigroup's due diligence personnel reevaluated certain of the vendors' loan grades and instructed its due diligence vendor to change some of those grades from an EV3 to an EV2 or EV1.

Notwithstanding the information Citigroup had received about the companies' loans, Citigroup purchased the loan pools and securitized loans from those pools in the four RMBS.