**MEMORANDUM FOR THE RECORD**

Event: Interview with Josh Anderson, PIMCO

Type of Event: Phone Interview

Date of Event: Tuesday, April 20, 2010 at 2:00 p.m.

Team Leader: Brad Bondi

Location: 1717 Pennsylvania Avenue NW, Suite 800, Washington, DC;

Participants - Non-Commission:

* Josh Anderson, PIMCO
* David Flattum, General Counsel of PIMCO

Participants - Commission:

* Brad Bondi
* Bruce McWilliams
* Karen Dubas

MFR Prepared by: Karen Dubas

Date of MFR: April 20, 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.**

**BONDI:** Mr. Anderson, we appreciate your time. You’re referenced in an internal Moody’s email that is posted on the House Oversight Committee’s website. Do you have a copy of the email in front of you?

**FLATTUM:** Yes, we have it here. I wasn’t sure what topics you wanted to go over today.

**BONDI:** I’m curious about the email. I think that’s the best starting place, and then we can talk about anything else he wants to share with us. We’re particularly interested in his concerns about Moody’s ratings.

[Gives standard FCIC introduction]. We’re interested in your knowledge of the rating agencies, particularly Moody’s. We might want to delve into the RMBS side. What do you do at PIMCO?

**ANDERSON:** I’m a portfolio manager and I’m in charge of structured credit research for the firm. I started here in March 2003. I’ve been in the same position since I started.

**BONDI:** What interactions have you had with Moody’s?

**ANDERSON:** I interact with Moody’s throughout the years on various transactions and deals. We don’t rely on Moody’s too much, but if a new deal came to market, we might call them up.

**BONDI:** Do you talk to them about RMBS or CDOs?

**ANDERSON:** Anything structured credit related.

**BONDI:** Do you deal with Moody’s to obtain a rating for something? What was your role in the process?

**ANDERSON:** No. Moody’s is a source of information for an investor. If we thought they had information, we’d try to get it.

**MCWILLIAMS:** Did you do independent research?

**ANDERSON:** Yes.

**MCWILLIAMS:** Is it for the purpose of making investments for your fund?

**ANDERSON:** Yes.

**BONDI:** Would you have interacted with Moody’s if they were rating a CDO?

**ANDERSON:** That would have come from the underwriters. That would have been their role.

**BONDI:** Was there a particular person that you interacted with on a regular basis? Was there a relationship manager assigned to PIMCO?

**ANDERSON:** I believe we had a relationship manager, but I almost never interacted with them. In general I would call the main switchboard and they would direct me to the correct person for the deal.

**MCWILLIAMS:** Did you deal with a handful of people?

**ANDERSON:** I didn’t really keep track of the names.

**BONDI:** Do you know Pramila Gupta?

**ANDERSON:** I believe she ran the RMBS group. She was pretty senior over there.

**MCWILLIAMS:** What about Jay Siegel?

**ANDERSON:** I know him. I had talked to him.

**BONDI:** I’d like to walk through the email in sections. Could you tell us if each section is something you remember discussing with Mary Elizabeth Brennen. To start, who is Mary Elizabeth Brennen?

**ANDERSON:** I don’t know. This would have been 8:30am on a Wednesday morning, so I probably just got a call from her.

**MCWILLIAMS:** Is it possible that you didn’t speak with her?

**ANDERSON:** I think I remember the conversation, but I never met the woman.

**BONDI:** In the email, she says that you started the discussion by saying that:

The recent downgrades ‘don’t help.’ Josh reported that PIMCO was surprised by the timing of the ratings actions. They thought that Moody’s would wait to downgrade bonds at the end of the summer or closer to the beginning of the fourth quarter. I asked if he thought the timing was appropriate and he responded, ‘You have to do what you have to do. You know what I mean?’

Do you remember saying those things to Brennan?

**ANDERSON:** Vaguely. The first few sentences don’t ring a bell. That was the time that they were downgrading some second liens. They took rating actions more than we would have thought at the time. I do remember that she asked if that would be appropriate, and I said that this is your decision.

**BONDI:** Can you describe what you meant in the second paragraph?

Josh’s main point is that PIMCO and others (he mentioned Blackrock and WAMCO) have previously been very vocal about their disagreements over Moody’s ratings methodology. He cited several meetings they have had with Pramila Gupta questioning Moody’s rating methodologies and assumptions. He found the Moody’s analyst to be arrogant and gave the indication that ‘We’re smarter than you.’ Despite wanting to work with Moody’s as a ‘good ally with good discussions,’ eventually they ‘gave up.’

**ANDERSON:** Through the years the rating agencies would call investors to get our feedback on the ratings. What we thought was wrong and what could be improved. We thought they should use an OES framework.

**BONDI:** What is an OES framework or an interest rate pass?

**ANDERSON:** When we model interest rate bonds, no one knows with certainty the level of interest rates. They can go all over the place. You run all sorts of scenarios, particularly in RMBS. We were more focused on prepayments than credit problems. The rating agencies only use 2-4 scenarios, and we thought that to give ratings based on only 4 interest rate paths was not looking at very many scenarios.

**BONDI:** They should use more scenarios

**ANDERSON:** Perhaps

**BONDI:** Were there other issues with their methodologies?

**ANDERSON:** Reps and warranties. The person who makes the mortgage should have at least some capital—if this loan is done in compliance with all laws, then there should be some capital supporting that.

If there were derivatives in a contract, it required an investment grade rating, but if they had reps and warranties, then they didn’t require investment grade. We talked about that for years and years. That was an issue when New Century went bankrupt.

**BONDI:** Other issues?

**ANDERSON:** Time frame. Given the limited history of the mortgage market, you have to have a level of conservatism. There were a lot of new products coming to the market, and there were only 10-15 years of market history. Subprime really only started in 1990.

**BONDI:** The email references “several meetings THEY have had with Gupta.” Who are “they”?

**ANDERSON:** Gupta used to run the RMBS group, and she used to make tours to our offices out here 2-3 times per year. It’s not clear if “they” means PIMCO or “they” means others.

**BONDI:** Were there any ratings that you believed were inflated for certain issuers? Did you feel like any particular issuers received favorable treatment of ratings from Moody’s?

**ANDERSON:** Not that I recall.

**BONDI:** Were there any specific concerns about ratings on RMBS from Countrywide?

**ANDERSON:** As a firm, we became more concerned. We were a pretty large investor in Countrywide up until 2005, and then we became cautious on Countrywide in general. I remember it was early 2006 when we changed our view on them. That was pretty common in the market. Our view evolved over time.

**BONDI:** When you were selecting RMBS for CDOs where PIMCO was the manager, were there particular RMBS issuers that you steered away from?

**ANDERSON:** There were absolutely issuers that we would avoid. It was never a function of the ratings. Ratings mattered to the degree that other market participants cared. There were certainly institutions in which we would only invest in certain bonds.

**BONDI:** Say there’s BBB RMBS from Acme and BBB RMBS from Beta. The ratings are the same, the mortgages are pretty much the same, but you choose Beta versus Acme. What would it be that would attract you to one versus the other?

**ANDERSON:** When you look at many of these investments, it was more complex than that. We’d look at the capital structure and the compensation. We’d look to see if we’d be compensated as justification for the risk. We’d never say that absolutely no we’d never buy Beta. I think one of the things we spent a lot of time on was the incentive structures for the internal sales force. That was a big indicator of performance for us. If they paid them a lot of money to originate loans, that was a big red flag for us. But it wasn’t just the originator—we’d look at the servicer as well.

**BONDI:** That’s very interesting. In terms of selecting the RMBS collateral for the CDO, how important were ratings in that process?

**ANDERSON:** Not very important. It wouldn’t affect the ratings in many CDOs. You have to buy bonds within the guidelines, but at the starting point it mattered very little.

**FLATTUM:** That’s because we do our own ratings for all bonds.

**BONDI:** The next paragraph talks about you being very passionate, almost emotional. The last few sentences say:

He complimented Moody’s work in CDOs and CLOs but, in the case of RMBS, its mistakes were ‘so obvious—you have to step back.’ I questioned him about Moody’s communication and timeliness but he said that it didn’t matter if the message communicated was ‘flawed.’

. Do you remember saying something along the lines of this?

**ANDERSON:** I don’t remember that kind of conversation all that well. It was probably a pretty busy time for me on the trading desk. Probably the point I was trying to make was that if we think you should be using OAS methodology, it doesn’t matter if you’re sending out emails, the original assumption you’re using can still be improved.

**BONDI:** Did you think that Moody’s did good work on the CDOs and not on the RMBS?

**ANDERSON:** Judging from the conversation, I was probably trying to compliment them—because I had been so negative, I was trying to say something positive.

**BONDI:** Were there flaws on the methodology for rating CDOs?

**ANDERSON:** On CDOs, you always struggle with correlation. We struggle with that as well.

**BONDI:** Did PIMCO use its own internal correlation to determine the risk on CDOs?

**ANDERSON:** Not really. Maybe in investment grade corporates, but not really in RMBS.

Given the correlation assumption that they were using to get a rating, we would look at whether that was appropriate. We were looking more at the investment quality—we weren’t as concerned with correlation.

When you rate a CDO, part of the analysis and the rating was based on the scenarios in which the assets could not perform. You were rated for having a diverse pool of assets. Theoretically, that would affect how you were rated and how much enhancement you would need to have.

When we rated bonds, we were looking at it from a very different framework.

**BONDI:** Was PIMCO as the manager ever buying a piece of the equity tranche?

**ANDERSON:** No.

**FLATTUM:** We’ve never invested in any part of a CDO that we’ve managed, nor do we buy to restructure. We avoid all conflicts of interest.

**BONDI:** The last paragraph talks about a proposed call with senior managers at Moody’s. Did that happen?

**ANDERSON:** No. they never followed up to my knowledge.

**BONDI:** It says that “PIMCO would go to bat for Moody’s?”

**ANDERSON:** I think I was trying to be more constructive and helpful rather than being critical. I was probably beating up on them.

**MCWILLIAMS:** They did their rating downgrades in the summer of 2007. Why did that upset you?

**ANDERSON:** I wasn’t upset. I was probably surprised.

**FLATTUM:** We’re a little confused about what she meant in the first paragraph as much as you are. We didn’t write it.

**BONDI:** We’re looking at the rating agencies and trying to understand anything the rating agencies did wrong. Can you give us a sense of other areas that we should focus on?

**ANDERSON:** From 2005-2008? Hindsight is always so obvious.

SIVs. We always really focused on that. If you have to go to the market for liquidity, that’s always a cause for concern. You can see that across many of the products that the rating agencies did in that period. They relied on the market to take them out. We’ve always been conscious of that. We’re very cautious with our investments.

**BONDI:** Did your work ever touch on the ratings related to the monoline insurers?

**ANDERSON:** We as a firm made a decision in 2003-4 to only buy standalone AAA bonds. If it had monoline insurance, we always tried to get the monoline insurance for free. If it takes a loss, the probability is that the monolines are in trouble as well. That’s a very simple assumption, but we didn’t focus very much on them. It turned out to be one of our better decisions. We weren’t very active in them.

**MCWILLIAMS:** Moody’s would make semi-annual marketing trips to see you?

**ANDERSON:** It’s a lot less frequent, but they do come to our offices frequently. In retrospect, a lot of the auto originators and subprime originators would have been by our offices as well. There was a mecca for subprime lenders in Newport Beach.

**BONDI:** What originators did you avoid buying RMBS from? Can we ask that?

**FLATTUM:** Sure. If there were people that we had doubts about, how would you decide that?

**ANDERSON:** You saw very explosive growth in the RMBS market, and we were always cautious of those folks who grew above the market. New Century and Fremont come to mind. It doesn’t mean that there could have been overriding factors in the purchasing of a bond that would make it acceptable from those originators.

I mentioned Countrywide in 2005-6. They were growing a lot faster than the overall market. We were concerned about the underwriting and the diligence that we were doing when we looked at the bonds for our investors. We didn’t stop with them altogether, but we became more cautious.

**BONDI:** What about Ameriquest?

**ANDERSON:** Ameriquest wasn’t, in our opinion, all that bad. For the most part they stayed in their niche. Obviously they grew. Argent got into trouble in 2004-5, and they were one of the ones that scaled back a lot sooner. Our view on Argent was that it wasn’t that bad as long as you stayed in the top of the capital structure.

**FLATTUM:** We were a more conservative investor. If you’re in the upper end of the capital structure, some of your concerns might be different than someone who’s in another position.

We’re trying to be helpful, but we don’t want to go on record saying that Countrywide or Argent were terrible. We’re just trying to give you flavor of what we’ve seen.

**BONDI:** Is there any material that you might be able to share with us in which an RMBS deal or a CDO was rated and you compared that rating to what your own internal due diligence team did? Where you’ve drawn some comparisons?

**ANDERSON:** Not that I recall. In RMBS, most of our investors in our client base were more investment grade rated. We’d look to see if this would maintain an investment grade rating. We wouldn’t look at whether it would be AA vs. A. That wouldn’t be helpful to us at all. We weren’t running a lot of structured products. If you were running SIVs, that might be more helpful.

**BONDI:** Were you investing in any CDO tranches?

**ANDERSON:** Very, very selectively.

**BONDI:** Did you buy super senior or higher level stuff during 2003-2008?

**ANDERSON:** We bought very few ABS CDO new issuances. We might have looked at a few in secondary trading. We might have been active very early in some super seniors. It would have been under $25 million—that’s very small for our firm. It would have been pre-2005, maybe even pre-2003.

**BONDI:** Were you buying secondary super seniors from the Wall Street banks?

**ANDERSON:** No. We have a little more recently, but not too much, no.

**BONDI:** If you’re making investments in RMBS, were there any materials that you might be able to share with us to help us understand the difference between one AAA versus another AAA?

**FLATTUM:** How do we do it? Do we have a manual or guidelines?

**ANDERSON:** The most obvious would be to take a pool from 2007 and run it through our model…

**BONDI:** Is there any background that you could give us?

**FLATTUM:** Are you thinking of valuation or ratings? We can ask around internally. We’re looking at a deal from the “would I buy it?” standpoint. We wouldn’t rely on someone else’s ratings, we’d look at the underlying security and decide what it’s worth to us and whether we want to buy it.

We’re more valuation and less ratings based in our analysis. Ratings are more interesting to us because they impact what other people pay for stuff, but not us.

We’ll look for it. I don’t know what work product we have. I appreciate the “deep background” concept because we want to make sure that any help we give is completing and not misleading.

**BONDI:** Is there anything you have similar to “here’s why ratings are not the only thing that you rely upon.” Something that explains why to an uneducated investor, these may look the same, but to an educated investor, this is why they’re very different?

**FLATTUM:** I understand what you’re saying. Maybe we can put something together for you similar to how Josh described reps and warranties.

**ANDERSON:** It could be related to what the embedded derivative in the deal might have been. If you have two deals with the same collateral valuation, but if only one has a big derivative in it, we would generally favor a deal that has a floor cap in it rather than an interest rate swap.

**BONDI:** I’m cognizant of proprietary models. I wouldn’t want you to reveal anything that could hurt your competitive advantage. But if you could put together something that helps us explain why you can’t just rely on ratings. That would be very helpful to us. It doesn’t have to be attributed back in any way to you.

**FLATTUM:** We’ll look for something, but we don’t have a manual about how to value things. That’s not really the pattern here. There’s less that we would have than other more bureaucratic places. I’ll look and see if we can find anything and talk to a few people.

**BONDI:** Is there anyone else who we should talk to about this?

**ANDERSON:** I think the people in the email are pretty good. I know Ron pretty well and I’ve met Mabel throughout the years.

**FLATTUM:** Much of the investment management landscape does rely on ratings. If you reach out to smaller investment managers, they might have more heavily relied upon them. I’m sure there would be people who would be glad to share how ratings served or dis-served them in the past.

**ANDERSON:** Or people who ran ratings-dependent structures like SIVs.

**BONDI:** Great. Thank you very much. Could you please keep this confidential other than following up on this call?

4828-7934-2598, v. 2