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Citigroup Team's Mortgage Bets Undeterred by Volcker Rule

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Anna Raytcheva's mortgage-bond bets for Citigroup Inc. (C) lost billions of dollars as the financial crisis raged. Now, amid new rules meant to curb banks' risky trading, she's gambling again.

Raised in communist Bulgaria, educated at Princeton University and seasoned by 20 years on Wall Street, she was put in charge of a four-person team this year to wager on U.S.- backed mortgage bonds. Her group in New York manages more than $1 billion for the bank and doesn't have clients, according to a person with direct knowledge of the unit.

Raytcheva, 41, has a rare mandate after banks cut or reassigned scores of proprietary traders, driving many to join hedge funds ahead of regulations that will limit the once-lucrative business of speculating for the accounts of the nation's biggest lenders. The rules, designed to prevent future calamities, haven't stopped her team: It's designed to fit within exemptions to foster markets for government securities.

Citigroup may be interpreting the exemptions more liberally than other firms, even after past missteps, according to Clifford Rossi, a former risk manager at the bank. The third-largest U.S. lender's catastrophic losses during the credit crisis prompted a $45 billion taxpayer bailout. Now led by Chief Executive Officer Michael Corbat, 54, it failed a Federal Reserve stress test in March for the second time in three years.

Anna Raytcheva, of Citigroup Inc., was put in charge of a five-person team this year to... Read More

"I would have expected Citi to take a different path," said Rossi, who left in 2009 and is now an executive-in-residence at the University of Maryland's Robert H. Smith School of Business in College Park. The team's existence is "surprising, and a little disappointing to be quite honest."

'Completely Secure'

U.S. regulators, in writing a rule named for former Fed Chairman Paul Volcker, sought to curb bank trading that isn't for clients. The law allows wagering in government securities, including more than $5 trillion of agency mortgage bonds guaranteed by Fannie Mae, Freddie Mac and Ginnie Mae.

Lawmakers sought the flexibility to finance government spending and didn't see the trading as particularly risky, said Barney Frank, who as a Massachusetts congressman helped draft the 2010 Dodd-Frank Act that mandated the Volcker Rule.

"To the extent the instruments being traded are completely secure, some of the rationale for the rule disappears," Frank, a Democrat, said in a phone interview.

Citigroup executives have said the bank is in compliance with the Volcker Rule. Speaking about the regulation in January, Chief Financial Officer John Gerspach, 60, said the lender had "already ceased proprietary-trading activities."

'Fully Compliant'

Asked about Raytcheva's team this month, Citigroup said in a statement that "the products traded in this business will be fully compliant with the Volcker Rule." They include Treasuries and U.S. agency securities that lawmakers specifically exempted, it said.

Scott Helfman, a spokesman for the New York-based bank, declined to make Raytcheva available for an interview, and she didn't respond to messages seeking comment. Spokesmen for the Office of the Comptroller of the Currency, the Fed and the Federal Deposit Insurance Corp., which regulate Citigroup, declined to comment.

Traders who make proprietary bets seek to generate profit for their banks by anticipating market moves or capturing price differences. Their work contrasts with those whose mission is to facilitate orders for clients and who invest the firm's excess cash with a mandate to earn interest income or maintain a pool of liquid assets.

Market-Making

The Volcker Rule, which takes effect in July 2015, focuses on proprietary trades lasting fewer than 60 days and doesn't limit most longer-term investments.

At least half a dozen Wall Street traders of agency mortgage bonds said they weren't aware of teams akin to Raytcheva's at firms including JPMorgan Chase & Co. (JPM), Bank of America Corp., Goldman Sachs Group Inc. (GS) and Morgan Stanley. Those banks do make markets in the securities and trade the debt for investment and hedging purposes. Goldman Sachs and Bank of America have said they also have separate units for long-term principal investing, including taking stakes in companies.

Raytcheva's team is on a separate floor from the market-making units at Citigroup's investment-banking headquarters in lower Manhattan, said people with knowledge of the group who asked not to be identified because the operations aren't public.

Goldman's View

The group uses a variety of strategies to beat returns available from simply buying mortgage bonds, one person said. Its investments include interest-only slices of collateralized mortgage obligations, or CMOs, a bet that can lose when rates fluctuate. A LinkedIn profile for Steve Xin, one of four analysts and traders reporting to Raytcheva, describes his work with "exotic rates" and relative-value strategies. Xin declined to comment.

Senior executives at two global banks, who asked not to be identified because they weren't authorized to speak about the matter, said they see the exemptions for government debt as geared toward market-making, which is why they don't have separate proprietary desks for the securities.

Citigroup's interpretation contrasts with that of Goldman Sachs, which concluded that "businesses that engage in 'bright line' proprietary trading were most likely to be prohibited," according to a filing this year from the New York-based firm. Spokesmen at Goldman Sachs, Bank of America, JPMorgan and Morgan Stanley declined to comment.

Lofty Returns

Trading strategies based on government securities can yield lofty returns. They also can generate losses when interest rates fluctuate, especially if the desk borrows to buy assets and juice profits, according to Josh Siegel, a former Citigroup banker and now CEO of StoneCastle Partners LLC in New York.

"Is there risk?" Siegel said. "Of course there is."

Trading in mortgage bonds, even those with U.S. backing, has a history of burning top Wall Street investors.

BlackRock Inc. CEO Laurence D. Fink, who helped pioneer the debt at First Boston Corp., lost $100 million in a quarter in 1986. One of the largest hedge-fund collapses was triggered when manager David J. Askin's investments in CMOs soured in 1994 after Fed rate increases. Metacapital Management LP's largest hedge fund, the industry's best-performing in 2012, lost 10 percent in a quarter last year amid speculation about Fed bond-buying and refinancing policies.

Unusually Treacherous

Bets on the debt may be unusually treacherous now with the Fed tapering bond purchases this year and interest rates poised to rise, said Anthony Sanders, a professor of real estate finance at

George Mason University in Fairfax, Virginia, and a former head of mortgage-bond research at Deutsche Bank AG.

“All it takes is a hiccup in rates and we could see some serious losses,” Sanders said. “As soon as the Fed stops buying these bonds, it’s going to be like musical chairs, and someone is going to end up with an empty seat.”

Raytcheva came to the U.S. in 1990 after the fall of the Berlin Wall, according to a 2013 article on Princeton’s website. She studied mathematics, graduating with honors in 1994, according to Martin Mbugua, a university spokesman.

That year she joined a predecessor of Citigroup. She traded interest-rate options and about a decade ago moved to a department called risk treasury, according to people who worked with her at the time.

Exotic Strategies

Before the 2008 financial crisis, risk-treasury traders who took care of cash for other groups sought more exotic strategies to boost returns, people who worked there said. Raytcheva sometimes brainstormed ideas with fixed-income proprietary traders who sat nearby, according to two former colleagues.

Her group amassed $30 billion in assets as the housing bubble inflated, two people with knowledge of the positions said. Some were in home-loan bonds that didn’t have government backing, bought from firms such as Lehman Brothers Holdings Inc. and tied to borrowers with weak credit profiles, the people said.

In November 2007, Citigroup announced that $55 billion in U.S. subprime-related exposures had plunged in value. CEO Charles O. “Chuck” Prince resigned.

The value of Raytcheva’s position dropped by at least $2 billion from the market’s peak to its lows in early 2009, though not all the paper losses were recognized because of accounting rules, according to a former colleague. She bought more securities as prices continued to slide in 2008, another person said. Raytcheva managed some of the assets after Citigroup placed them into a pool of other soured holdings.

Toxic Assets

To some inside Citigroup, Raytcheva is known as an able mathematician skilled at managing mortgage-bond risks from swings in interest rates.

“She can be dogmatic, but she’s very smart,” Greg Hawkins, Citigroup’s global head of real estate and market risk before he left the bank in 2013, said in a telephone interview.

About five years ago, Raytcheva joined the team she now runs. She brought in Mark Zarkhin as a trader from another part of the bank. When she added responsibility for the market-making agency-mortgage business in early 2011, she left Zarkhin in charge of the smaller team.

Her new role brought turmoil. At least eight traders left the client-facing desk during her tenure, including Vadim Khazatsky, a more-than 20-year veteran, and Mike Peragine, who joined in 1996, according to regulatory records. Some of the departures reflected a clash of personalities and disagreements over trading decisions, the people said.

Raytcheva led the group in 2011 into bets involving derivatives tied to large groups of mortgage bonds called MBX index contracts, which lost about $50 million, according to two people.

Scholarship Fund

Earlier this year, she took over Zarkhin's role as he left for hedge fund Millennium Management LLC, and the group continued making proprietary trades. She reports to Mark Tsesarsky, co-head of securitized products at Citigroup's investment bank. Her group trades assets including pools of mortgage bonds with unique characteristics and derivative instruments tied to indexes that reference pools of agency bonds, looking for opportunities to arbitrage, or benefit by taking advantage of price differences, the people said.

Within the bank, people refer to her group's focus as strategic trading. Members of her team include Xin, Sumeet Kapur, Matt Milroy and Tom Rose, according to one person. People who answered the team's phone line hung up or referred calls to the bank's spokesmen.

'Run Afoul'

"At one point, she thought at Citigroup that she was spending too much time managing people, and I think she seemed to prefer the smaller team that she has now," said Gary T. Capen, a friend whose scholarship fund for international women supported Raytcheva's education at Princeton.

Raytcheva now helps fund Capen's program and has donated to the New York Philharmonic and International Preschools of New York. She owns a condominium in Palm Beach, Florida, and a home about 50 miles south of the Vermont ski-resort town of Killington, Capen said.

"That's really where she gets her relief," he said.

While proprietary trading in government-backed securities is allowed under Dodd-Frank, the final version of the Volcker Rule adopted by regulators limits the exemption if the trading involves conflicts of interest, exposure to high-risk strategies or risks to the safety of the financial system.

Mark Calabria, director of financial-regulation studies at the Cato Institute, the Washington-based group that supports free markets, said Raytcheva's desk raises questions about how banks are continuing to take risks.

“This could run afoul of the spirit of the law,” he said.