United States of America

Financial Crisis Inquiry Commission

INTERVIEW OF

WARREN BUFFETT

Wednesday, May 26, 2010

9:59 a.m. 11:50 a.m. CDT

***** Confidential *****

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MR. BONDI: It is 9:59 a.m. on May 26th, 2010. We are in Omaha, Nebraska, for the interview of Warren Buffett.

I am Brad Bondi, B-O-N-D-I, of the Financial Crisis Inquiry Commission. With me from the Financial Crisis Inquiry Commission is Gary Cohen, C-O-H-E-N, and Chris Seefer.

We are joined by Mr. Warren Buffett and Tracy --

MR. BUFFETT: Britt.

MR. BONDI: -- Britt. B-R-I-T-T?

MS. BRITT: Uh-huh.

MR. BONDI: Thank you.

Mr. Buffett, we are with the staff of the Financial Crisis Inquiry Commission. We were formed by Congress in 2009 to investigate the causes of the financial crisis, both globally and domestically, and to do a report due at the end of this year, December 15, 2010, to the President and to Congress, which we also plan to release to the American public.

We're tasked not only with investigating the causes of the financial crisis, but looking at specific

issues that Congress has enumerated in the Fraud Enforcement Recovery Act, which formed the Commission.

The Commission is a bipartisan commission, six Democrats and four Republican commissioners, and we are with the staff of the Commission.

We wanted to ask you a few questions today, and get your views and your insights so that we may better understand the causes of the financial crisis. In addition, we would like to ask you a few questions about Moody's as well, since you are a significant shareholder in Moody's.

And if you don't mind, let's ask first about Moody's specifically.

MR. BUFFETT: Uh-huh.

MR. BONDI: I understand, sir, that in 1999 and in February 2000, you invested in Dun and Bradstreet.

MR. BUFFETT: That's correct. I don't have the dates, but that sounds right. Yes, sir.

MR. BONDI: And am I correct, sir, in saying you made no purchases after Moody's spun off from Dun and Bradstreet?

MR. BUFFETT: I believe that's correct.

MR. BONDI: Okay. What kind of due diligence did you and your staff do when you first purchased

Dun and Bradstreet in 1999 and then again in 2000?

MR. BUFFETT: Yes. There is no staff. I make all the investment decisions, and I do all my own analysis. And basically it was an evaluation of both Dun and Bradstreet and Moody's, but of the economics of their business. And I never met with anybody.

Dun and Bradstreet had a very good business, and Moody's had an even better business. And basically, the single-most important decision in evaluating a business is pricing power. If you've got the power to raise prices without losing business to a competitor, you've got a very good business. And if you have to have a prayer session before raising the price by a tenth of a cent, then you've got a terrible business. I've been in both, and I know the difference.

MR. BONDI: Now, you've described the importance of quality management in your investing decisions and I know your mentor, Benjamin Graham -- I happen to have read his book as well -- has described the importance of management.

What attracted you to the management of Moody's when you made your initial investments?

MR. BUFFETT: I knew nothing about the management of Moody's. The -- I've also said many times in reports and elsewhere that when a management with

reputation for brilliance gets hooked up with a business with a reputation for bad economics, it's the reputation of the business that remains intact.

If you've got a good enough business, if you have a monopoly newspaper, if you have a network television station -- I'm talking of the past -- you know, your idiot nephew could run it. And if you've got a really good business, it doesn't make any difference.

I mean, it makes some difference maybe in capital allocation or something of the sort, but the extraordinary business does not require good management.

MR. BONDI: What interaction --

MR. BUFFETT: I'm not making any reference to Moody's management, I don't really know them. But it really -- you know, if you own the only newspaper in town, up until the last five years or so, you have pricing power and you didn't have to go to the office.

MR. BONDI: And do you have any opinions, sir, of how well management of Moody's has performed?

MR. BUFFETT: It's hard to evaluate when you have a business that has that much pricing power. I mean, they have done very well in terms of huge returns on tangible assets, almost infinite. And they have -- they have grown along with the business that generally the capital markets became more active and all that.

So in the end -- and then raised prices -- we're both -- we're a customer of Moody's, too, so I see this from both sides, and -- we're an unwilling customer, but we're a customer nevertheless. And what I see as a customer is reflected in what's happened in their financial record.

MR. BONDI: And I've seen in many places where you've been referred to as a passive investor in Moody's. Is that a fair characterization, and what sort of interactions and communications have you had with the board and with management at Moody's?

MR. BUFFETT: At the very start, there was a fellow named Cliff Alexander who was the chairman of Dun and Bradstreet while they were breaking it up.

He met me -- I met him in connection with something else, years earlier; and so we had a lunch at one time. But he wasn't really an operating manager. He was there sort of to see -- oversee the breakup of the situation.

Since we really own stock in both Dun and Bradstreet and Moody's when they got split up, I've never been in Moody's office, I don't think I've ever initiated a call to them. I would say that three or four times as part of a general road show, their CEO and the investor relations person would stop by and -- and

they think they have to do that. I have no interest in it basically, and I never requested a meeting. It just -- it was part of what they thought investor relations were all about. And we don't believe much in that.

MR. BONDI: What about any board members? Have you pressed for the election of any board member to Moody's --

MR. BUFFETT: No, no --

MR. BONDI: -- board?

MR. BUFFETT: -- I have no interest in it.

MR. BONDI: And we've talked about just verbal communications. Have you sent any letters or submitted any memos or ideas for strategy decisions at Moody's?

MR. BUFFETT: No.

MR. BONDI: In --

MR. BUFFETT: If I thought they needed me, I wouldn't have bought the stock.

MR. BONDI: In 2006, Moody's began to repurchase its shares, buying back its shares that were outstanding, and they did so from 2006 to 2008, according to our records.

Why didn't you sell back your shares to Moody's at that time? I know subsequent in 2009 you sold some shares, but from '06 to '09, during the

buyback, did you consider selling your shares back, and if so, why didn't you?

MR. BUFFETT: No, I thought they had an extraordinary business, and -- you know, they still have an extraordinary business. It's now subject to a different threat, which we'll get into later, I'm sure.

MR. BONDI: Uh-huh.

MR. BUFFETT: But -- but I made a mistake in that it got to very lofty heights and we didn't sell -- it didn't make any difference if we were selling to them or selling in the market. But there are very few businesses that had the competitive position that Moody's and Standard and Poor's had. They both have the same position, essentially. There are very few businesses like that in the world. They are -- it's a natural duopoly to some extent. Now, that may get changed, but it has historically been a natural duopoly, where anybody coming in and offering to cut their price in half had no chance of success. And there's not many businesses where someone can come in and offer to cut the price in half and somebody doesn't think about shifting. But that's the nature of the ratings business. And it's a naturally obtained one.

It's assisted by the fact that the two of them became a standard for regulators and all of that, so

it's been assisted by the governmental actions over time. But it's a natural duopoly.

MR. BONDI: Now, Mr. Buffett, you've been reported as saying that you don't use ratings.

MR. BUFFETT: That's right.

MR. BONDI: But the world does.

MR. BUFFETT: That's right.

MR. BONDI: And my question is --

MR. BUFFETT: But we pay for ratings, which I don't like.

MR. BONDI: My question is one of more policy and philosophy and, that is, would the American economy be better off in the long run if credit ratings were not so embedded in our regulations and if market participants relied less on credit ratings?

MR. BUFFETT: Well, I think it might be better off if everybody that invested significant sums of money did their own analysis, but that is not the way the world works. And regulators have a terrible problem in setting capital requirements, all of that sort of thing, without some kind of standards that they look to, even if those are far from perfect standards. And so I can't really judge it perfectly from the regulator's standpoint.

From the investor's standpoint, I think

investors should do their own analysis and we always do.

MR. BONDI: Would you support the removal of references to credit ratings from regulations?

MR. BUFFETT: That's a tough question. I mean, you get into -- you get into, you know, how you regulate insurance companies and banks. And we are -- we're very significantly in the insurance business and we are told that we can only own triple-B and above and different -- there are all kinds of different rules in different states and even different countries, and those may serve as a crude tool to determine proper capital or to prevent buccaneers of one sort from going out and speculating in the case of banks with money that's obtained for a government guarantee, so that is not an easy question.

MR. BONDI: As I mentioned at the outset, we're investigating the causes of the financial crisis. And I would like to get your opinion as to whether credit ratings and their apparent failure to predict accurately credit quality of structured finance products, like residential mortgage-backed securities and collateralized debt obligations, did that failure, or apparent failure, cause or contribute to the financial crisis?

MR. BUFFETT: It didn't cause it, but there

were a vast number of things that contributed to it. The basic cause, you know, embedded in psychology -- partly in psychology and partly in reality in a growing and finally pervasive belief that house prices couldn't go down and everyone succumbed -- virtually everybody succumbed to that. But that's -- the only way you get a bubble is when basically a very high percentage of the population buys into some originally sound premise and -- it's quite interesting how that develops -- originally sound premise that becomes distorted as time passes and people forget the original sound premise and start focusing solely on the price action.

So every -- the media investors, the mortgage bankers, the American public, me, my neighbor, rating agencies, Congress -- you name it -- people overwhelmingly came to believe that house prices could not fall significantly. And since it was biggest asset class in the country and it was the easiest class to borrow against, it created probably the biggest bubble in our history.

It will be a bubble that will be remembered along with the South Sea bubble and the tulip-bulb bubble.

MR. BONDI: I do want to ask you some questions about the formation of that bubble. If I may

ask a couple more on the rating-agency side --

MR. BUFFETT: Sure.

MR. BONDI: -- and then shift to that.

And that is, do I take it though that you believe at least the failure of the ratings contributed in some part to the financial crisis?

MR. BUFFETT: I do, but I do think it was -- I think every aspect of society contributed to it virtually, but they fell prey to the same delusion that existed throughout the country eventually and it meant that the models that they had were no good.

They didn't contemplate -- but neither did the models in the minds of 300 million Americans contemplate -- what was going to happen.

MR. BONDI: And similarly, sir, the rating agencies, both Moody's and S&P, downgraded securities en masse in July of 2007 -- July, roughly starting around July 10th, 2007, and then again in mid October of 2007. Many have pointed to these downgrades as contributing to the crisis.

Do you believe that these downgrades, the sudden downgrades contributed to uncertainty in the market or the looming crisis?

MR. BUFFETT: Well, I think that the realization by people that a bubble was starting to pop.

And, you know, everybody doesn't wake up at 6:00 a.m. on some morning and find it out.

But, you know, Freddie Mac, Fannie Mae, they all felt different in the middle of 2007 than they did in the middle of 2006 or 2005, so…

MR. BONDI: Uh-huh.

MR. BUFFETT: People were watching a movie and they thought the movie had a happy ending; and all of a sudden, the events on the screen started telling them something different. And different people in the audience picked it up at maybe different hours, different days, different weeks. But at some point, the bubble popped and it, for different people, they were seeing it at slightly different times.

But you could say the media caused it, too. They said the bubble is popping.

It -- the recognition of it by the rating agencies may have told a whole bunch of people, that previously hadn't been paying much attention, that it was happening. The reports coming out of Freddie and Fannie may have told people that. What was happening at Countrywide -- I think that was the summer of 2007 -- certainly was telling people that. So it was dawning on people in a wave, sort of, that what they believed wasn't true.

MR. BONDI: Now, I read in one of your shareholder letters, I thought you appropriately said, "A pin lies in wait for every bubble."

MR. BUFFETT: And this was the biggest one.

MR. BONDI: When did you realize that there was a mortgage meltdown coming and if so, what steps did you take to prepare for it and if not, why were you unable -- as one of the purportedly wisest investors in the United States, why were you unable to spot this massive bubble growing?

MR. BUFFETT: The answer is, the first part was not soon enough. And it was something we talked about in our annual meetings. And I think at one point I referred to it as a "bubblelet." I don't remember what year that was, but…

And I talked about my home in Laguna where the -- where the implicit value of the land had gotten up to $30 million an acre or something like.

But the nature of the bubbles is that, you know -- the Internet bubble, I was aware too, but I didn't go out and short the stocks. I never shorted the Internet stocks and I didn't short housing stocks. Looking back, you know, "Hey, we don't short around here." But if I had seen what was coming, I would have behaved differently, including selling Moody's. So I

was wrong.

MR. BONDI: We've obviously had bubbles in the past, as you've pointed out with the Internet bubble and others. But at least in recent times, we've never had a financial crisis as severe as the one we're living through now.

When did it dawn on you that this bubble bursting and this financial crisis was going to be different than none others in recent time?

MR. BUFFETT: Well, it -- unfortunately it's a gradual process, and, you know, you get wise too late.

When it really became apparent, that this was something like you've never seen one like in September 2008, that's when I said on CNBC, "This is an economic Pearl Harbor."

Well, it was an economic Pearl Harbor. By definition, I meant that I hadn't seen it three months earlier because I didn't see a Pearl Harbor three months earlier. So it -- there were all kinds of developments, but the degree to which it would stop the financial system, you know, and then with the consequent overflow into the economy. Until September of 2008, I didn't fully realize.

MR. BONDI: What do you think it was, if you were to point to one of the single driving causes behind

this bubble? What would you say?

MR. BUFFETT: Well, there's a very interesting aspect of this, which will take a minute or two to explain; but what my former boss, Ben Graham, made an observation, 50 or so years ago to me that it really stuck in my mind and now I've seen evidence of it.

He said, "You can get in a whole lot more trouble in investing with a sound premise than with a false premise."

If you have some premise that the moon is made of green cheese or something, it's ridiculous on its face. If you come out with a premise that common stocks have done better than bonds -- and I wrote about this in *Fortune* article in 2001 -- because there was a famous little book in 2001 by Edgar Lawrence Smith -- in 1924 by Edgar Lawrence Smith that made a study of common stocks versus bonds. And it showed -- he started out with the idea that bonds would overperform during deflation and common stocks would overperform during inflation. He went back and studied a whole bunch of periods and, lo and behold, his original hypothesis was wrong. He found that common stock always overperformed. And he started thinking about that and why was that.

Well, it was because there was a retained earnings factor. They sold -- the dividend yield on

stocks was the same as the yield on bonds, and on top of it, you had retained earnings. So they overperformed.

That became the underlying bulwark for the '29 bubble. People thought stocks were starting to be wonderful and they forgot the limitations of the original premise, which was that if stocks were yielding the same as bonds, that they had this going *[unintelligible]*.

So after a while, the original premise, which becomes sort of the impetus for what later turns out to be a bubble is forgotten and the price action takes over.

Now, we saw the same thing in housing. It's a totally sound premise that houses will become worth more over time because the dollar becomes worth less. It isn't because -- you know, construction costs go up. So it isn't because houses are so wonderful, it's because the dollar becomes worth less, and that a house that was bought 40 years ago is worth more today than it was then.

And since 66 or 67 percent of the people want to own their own home and because you can borrow money on it and you're dreaming of buying a home, if you really believe that houses are going to go up in value, you buy one as soon as you can. And that's a very sound

premise. It's related, of course, though, to houses selling at something like replacement price and not far outstripping inflation.

So this sound premise that it's a good idea to buy a house this year because it's probably going to cost more next year and you're going to want a home, and the fact that you can finance it gets distorted over time if housing prices are going up 10 percent a year and inflation is a couple percent a year. Soon the price action -- or at some point the price action takes over, and you want to buy three houses and five houses and you want to buy it with nothing down and you want to agree to payments that you can't make and all of that sort of thing, because it doesn't make any difference: It's going to be worth more next year.

And lender feels the same way. It really doesn't make a difference if it's a liar's loan or you know what I mean? *[Unintelligible]* something because even if they have to take it over, it's going to be worth more next year.

And once that gathers momentum and it gets reinforced by price action and the original premise is forgotten, which it was in 1929.

The Internet was the same thing. The Internet was going to change our lives. But it didn't mean that

every company was worth $50 billion that could dream up a prospectus.

And the price action becomes so important to people that it takes over the -- it takes over their minds, and because housing was the largest single asset, around $22 trillion or something like that, not above household wealth of $50 trillion or $60 trillion or something like that in the United States. Such a huge asset. So understandable to the public -- they might not understand stocks, they might not understand tulip bulbs, but they understood houses and they wanted to buy one anyway and the financing, and you could leverage up to the sky, it created a bubble like we've never seen.

MR. BONDI: Uh-huh.

MR. BUFFETT: And I wish I had figured that out in 2005.

MR. BONDI: The -- this bubble, though, has been described as different from prior housing bubbles and certainly the forces that you've described about prices and certainly the types of loans that you've described have been around for a while. What do you think, though, made this particular housing bubble different and what would you point to, to the growth of this particular housing bubble?

Some have pointed to cheap money, in essence.

Some have pointed to lack of regulation in the origination business. Some have pointed to the drive from Wall Street for securitized mortgages and RMBS and then as collateral for CDOs. Others have pointed to government policy that created the housing bubble.

What do you think created and caused this housing bubble?

MR. BUFFETT: That's a great question to which I don't have a great answer.

Why did the -- I read that the tulip bulb was in 1610 or 1620, but tulips had been around before, and they always looked beautiful and people wanted them on their tables and all that. For some reason, it gets to a critical mass, a critical point is that where the price action alone starts dominating people's minds.

And when your neighbor has made a lot of money by buying Internet stocks; and your wife says that, "You're smarter than he is and he's richer than you are, so why aren't you doing it?" When that gets to a point -- when day trading gets going, all that sort of thing, it's very hard to point to what does it.

I mean, you know, we've had hula hoops in this country and we've had pet rocks, I mean; and this is financial manifestation of a craze of sorts. And I -- it's very hard to tell what was --

All of us name a lot of factors that contribute to it, but to say what was the one that this time was different than -- why it didn't catch fire earlier, I can't give you the answer.

MR. BONDI: You don't make our job any easier.

MR. BUFFETT: Well, no, you know, if *[unintelligible]* I would have probably written an essay on it or something by this point. I mean, no, I think it's going to defy an answer to be perfectly honest. That doesn't mean that your time is wasted or anything.

Understanding the pathology of bubbles is not an unimportant -- we had one that was more severe -- in fact there was an article in the *Omaha World-Herald* about three months ago that described about how it was more severe. We had a bubble in the Midwest in the early '80s in farmland that created much more financial dislocation, but it was limited to the farm belt, than this particular bubble has, which has not hit us hard in terms of housing in the Midwest.

So Nebraska was much harder hit in the farmland bubble. And the farmland bubble had the same logic to it: Inflation was out of control. Volcker hadn't really come in with his meat axe yet to the economy; and people said, "They're not making any more farm land, there are going to be more people eating.

Farmland gets more productive by the year. We learn more about fertilizers and all that sort of thing, and cash is trash, so you should go and own something real, which was a farm."

And I bought a farm from the FDIC -- or Resolution Trust -- well, no, it was the FDIC, I think, they took over a bank 30 miles from -- and I bought a farm for $600 an acre that the bank had lent $2,000 an acre against. And the farm didn't know what I paid for it or the other guy paid *[unintelligible]* -- that farm had a productive capacity of probably $60 an acre in terms of what corn and soybeans were selling for. To lend $2,000 against it when interest rates were 10 percent was madness. And both the banks in Techama, Nebraska, went broke because they went insane. They got through the '30s all right, but this psychology that farms could do nothing but go up took over, and that was a -- that was a significant miniature version of what could happen with houses, country-wide.

MR. BONDI: Now, earlier you referenced the GSEs and it's been reported than in 2000 you sold nearly all of your Freddie Mac and Fannie Mae shares.

What persuaded you in 2000 to think that those were no longer good investments?

MR. BUFFETT: Well, I didn't know that they

weren't going to be good investments, but I was concerned about the management at both Freddie Mac and Fannie Mae, although our holdings were concentrated in Fannie Mac.

They were trying to -- and proclaiming that they could increase earnings per share in some low double-digit range or something of the sort. And any time a large financial institution starts promising regular earnings increases, you're going to have trouble, you know?

I mean, it isn't given to man to be able to run a financial institution where different interest-rate scenarios will prevail on all of that so as to produce kind of smooth, regular earnings from a very large base to start with; and so if people are thinking that way, they are going to do things, maybe in accounting -- as it turns out to be the case in both Freddie and Fannie -- but also in operations that I would regard as unsound. And I don't know when it will happen. I don't even know for sure if it will happen. It will happen eventually, if they keep up that policy; and so we just decided -- or I just decided to get out.

MR. BONDI: The *Washington Post* reported on October 31st, 2007, that you had provided some testimony the day before in a case against Freddie Mac's CEO where

you had indicated that you became troubled when Freddie Mac made an investment unrelated to its mission. And you were quoted in that article as saying that you didn't think that it made any sense at all and you were concerned about what they might be doing that I didn't know about.

MR. BUFFETT: Yes, well, that was --

MR. BONDI: What was that investment that was unrelated to its mission?

MR. BUFFETT: As I remember, it was Phillip Morris bonds. I could be wrong. It might have been R.J. Reynolds or something. But they had made a large investment in that.

Now, they are dealing essentially with government-guaranteed credit, so we know about that and we had it ratified subsequently about what has happened. So, here was an institution that was trying to serve two masters: Wall Street and their investors, and Congress. And they were using this power to do something that was totally unrelated to the mission. And then they gave me some half-baked explanation about how it increased liquidity, which was just nonsense.

And the truth was that they were arbitraging the government's credit, and for something that the government really didn't intend for them to do. And,

you know, there is seldom just one cockroach in the kitchen. You know, you turn on the light and, all of sudden, they all start scurrying around. And I wasn't -- I couldn't find the light switch, but I had seen one.

MR. BONDI: Shifting to more recent times, you've made investments in Goldman Sachs in September of 2008, and in General Electric.

What were your considerations when you made those investments and were you persuaded by any government official to make those investments?

MR. BUFFETT: Oh, no, I wasn't persuaded by it. I was, in my own mind, I -- there was only way both the financial world and the economy was going to come out of this situation of paralysis in September of 2008, and that was -- I made the fundamental decision that we had really the right people in Bernanke and Paulson in there, where the President would back them up. That we had a government that would take the action and only the government could take the action to get an economic machine that had become stalled, basically, back into action. And I didn't know what they would do. I didn't know what Congress would go -- it really didn't make much difference. The important thing was that the American public would come to believe that our

government would do whatever it took. And I felt it would -- it would have been suicide not to, but it hadn't been done in the early '30s. And therefore, I felt companies like General Electric or Goldman Sachs were going to be fine over time. But it was a bet essentially on the fact that the government would not really shirk its responsibility at the time like that, to leverage up when the rest of the world was trying to de-leverage and panicked.

MR. BONDI: Around that same time, on October 17th, 2008, you wrote an op-ed piece in the *New York Times,* on why you were buying American stocks.

And did anyone from the federal government or the Federal Reserve ask you to write that?

MR. BUFFETT: No, no.

MR. BONDI: And similarly, I know you weren't persuaded by anything that the government asked you to do, but did anyone ask you to make any investments in financial companies such as --

MR. BUFFETT: No.

MR. BONDI: -- Goldman --

MR. BUFFETT: Well, Goldman asked me to, and GE asked me to. And a number of other companies asked me to, but nobody from government.

MR. BONDI: No one from government?

MR. BUFFETT: No.

MR. BONDI: Now, both --

MR. BUFFETT: I have actually touched *[unintelligible]* and the connection with Lehman was trying to raise some money in the spring of 2008 and Dick Fuld was calling me and he did get Hank Paulson to call but Hank did not urge me to buy it. He was responding to the entreaties of Fuld that he make a call, but I was not asked to buy anything.

MR. BONDI: Do you --

MR. BUFFETT: It wouldn't have done any good if he had asked.

MR. BONDI: Do you believe that your prominence as an investor and your stock purchases could alleviate the financial crisis? Was that --

MR. BUFFETT: That was not a motivation.

MR. BONDI: Was that a consideration?

MR. BUFFETT: No, no. I -- my public spirit stops short of $8 billion.

MR. BONDI: Would the American economy have been better off in the long run if there had been no exceptional government assistance to financial institutions? In other words, do you think we've increased the likelihood of moral hazard in the long run?

MR. BUFFETT: No, I think the moral hazard has been misunderstood in a big way. There is no moral hazard existing with shareholders of Citigroup, with Freddie Mac, with Fannie Mae, with WaMu, with Wachovia -- you just go up and down the line. I mean, those people lost anywhere from 90 percent to 100 percent of their money, and the idea that they will walk away and think, "Ah, I've been saved by the federal government."

I think just the companies that I've named there's at least a half a trillion dollars of loss to common shareholders.

Now, there's another question with management, which we might get into later, but in terms of moral hazard, I don't even understand why people talk about that in terms of equity holders.

MR. BONDI: Uh-huh. Do you think we would have been better off, though, if we had not had the infusion of government assistance?

MR. BUFFETT: I think it would be a disaster. No, it would have been the disaster of all time.

MR. BONDI: I'd like for you to try to help me square something you've been quoted as saying about credit default swaps, and I'm sure my colleague, Chris Seefer, has been focusing on these areas will ask you

additional questions.

But you've been quoted as saying "Credit default swaps were financial weapons of mass destruction."

MR. BUFFETT: Well, I know I said derivatives.

MR. BONDI: Derivatives?

MR. BUFFETT: Yes.

MR. BONDI: Excuse me.

MR. BUFFETT: -- *[unintelligible]* financial.

Systemically, they represented the potential for being financial weapons of mass destruction and I don't think there's any question about them.

MR. BONDI: And in 2008, you began to invest in credit default swaps. And I understand that --

MR. BUFFETT: Yes, we've sold insurance for a lot of years, and sometimes that's credit insurance. And, you know, I don't think the way -- I don't see a connection between selling insurance and thinking something can be systemically dangerous if again carried to extremes in terms of the leverage produced and the scope of contracts entered in. But I don't see anything improper about credit insurance.

MR. BONDI: So --

MR. BUFFETT: Banks have been doing that for decades with letters of credit and that sort of the

thing.

MR. BONDI: In terms of, though, your concern with derivatives, is it a question of the type of product, or is it a question of the use, or both?

MR. BUFFETT: It's a question of being -- it's the ability to inject enormous amounts of leverage into a system whereby it is dangerous. And without people fully appreciating the amount of leverage and as a handmaiden of leverage, a risk of counterparties running up huge amounts of receivables and payables. You know, one of the reasons stock markets work well is that you've got a three-day settlement period. But if you had a one-year settlement period -- in fact, I think over in Kuwait they did that some years ago, when they had a total debacle -- you would have far more problems.

Well, derivatives involves a very, very long settlement period and things can happen between when you write a contract; and if you have settlement period -- and there was one at Gen Re that was 100 years -- it's very hard to predict the behavior of somebody else 100 years from now. And derivatives present big problems. Now, if there's only a small amount in use, it doesn't make that much difference in the system. But as they became more and more pervasive and more and more imaginative and less -- and in effect, very little

attention being paid to them, which is why I sounded a warning. I don't think they're evil, per se. It's just -- I mean, there's nothing wrong with having a futures contract or something of the sort, but they do let people engage in massive mischief, and the thing that I found really extraordinary -- Chris, do you mind giving me that letter -- I mean I wrote this letter in 1982, to Congressman Dingell about the dangers of it.

The -- here, you've got a commission that's doing what Pecora did, you know, many years ago, and when we had those hearings after '29, we decided leverage was dangerous for people, and it could cause systemic problems, when used in the stock market. And we have the Federal Reserve power to determine margin requirements. We said that was important and if people got overleveraged in the stocks, they could cause a problem not only for themselves but for others if it was done on a wide scale.

And then we came along in 1982, and we, in a sense, opened up leverage to anybody in extreme measures and since that time -- it's 28 years since then. I and perhaps others -- but I know I pointed out at least 20 times the really nonsense of saying -- and still having the Federal Reserve telling people they can only borrow 50 percent against stock or whatever the margin

requirements have been at various times, and then at the same time, telling them you can go gamble in S&P futures or something the 2 percent or 3 percent margin or whatever it might be. And to this day -- and I've talked to Congress about it. To this day, we sit there, with a system, where the Federal Reserve is telling you how much you can borrow against stocks and we've got this parallel system where people can gamble anything they want virtually, in terms of the most obvious one being the S&P futures. And I have seen no attempt by anybody to address that total contradiction.

It might be a suggestion for your commission.

MR. BONDI: You know, on that vein, we've been charged with talking about excess risk and excess speculation and I know you've commented on what you view as speculation in one of your letters, but we've had some internal conversations within the Commission itself about the use of the term "speculation" and whether it's a --

MR. BUFFETT: It's a -- defining investment speculation and gambling is an interesting question.

MR. BONDI: Yes, I'd be interested in what you think speculation is, as opposed to investing, which you've written about and also what you think excess speculation or excess risk is in that context.

MR. BUFFETT: It's a tricky definition. You know, it's like pornography, and that famous quote on that. But I look at it in terms of the intent of the person engaging in the transaction, and an investment operation -- though, it's not the way Graham defines it in his book, but investment operation in my view is one where you look to the asset itself to determine your decision to lay out some money now to get some more money back later on.

So you look to the apartment house, you look to the stock, you look to the farm, in terms of what that will produce. And you don't really care whether there is a quote on it at all. You are basically committing some funds now to get more funds later on, through the operation of the asset.

Speculation, I would define as much more focused on the price action of the stock, particularly that you, or the index future, or something of the sort. Because you are not really -- you are counting on -- for whatever factors, because you think quarterly earnings are going to be up or it's going to split, or whatever it may be, or increase the dividend -- but you are not looking to the asset itself.

And I say, the real test of how you -- what you're doing is whether you care whether the markets are

open.

When I buy a stock, I don't care if they close the stock market tomorrow for a couple of years because I'm looking to the business -- Coca-Cola, or whatever it may be, to produce returns for me in the future from the business.

Now, if I care if whether the stock market is soap tomorrow, then to some extent I'm speculating because I'm thinking about whether the price is going to go up tomorrow or not. I don't know whether the price is going to go up.

Gambling -- but -- and then gambling, I would define as engaging in a transaction which doesn't need to be part of the system. I mean, if I want to bet on a football game, you know, the football's game's operation is not dependent on whether I bet or not.

Now, if I want to bet on October wheat, or something of the sort, people have to raise wheat. And when they plant it, they don't know what the price is going to be later on. So you need activity on the other side of that, and you may only be speculating on the other side. But it is not an artificial transaction that has no necessity for existing in an economic framework.

And the gambling propensity with people is

huge. I mean, you took -- you took, you know, some terrible sand out in the west, about a hundred years ago, and you created a huge industry, with people flying thousands of miles to do things which were mathematically unintelligent.

Now, that is -- shows something in mankind, is a strong, strong behavioral -- it has a strong behavioral aspect to it.

And think how much easier it is to sit there in front of a computer, and have the same amount of fun, without, you know, getting on a plane and going a thousand miles and having to make reservations and do all that sort of thing.

So -- but this propensity to gamble encouraged incidentally by the state with lotteries, you know, that have terrible odds attached to them. People don't have to be trained to want to gamble in this country, but they have this instinct -- a great many people -- they're encouraged when they see some successes around. That's why the bells and whistles go off in the casino when somebody hits a jackpot, you know.

So you have all these things pushing to that, including governmental urging of, "Buy lottery tickets," and all that sort of thing. And now you've got a vehicle like, you know, S & P futures or something,

where you can go in and out, and where Congress has granted particularly favorable tax treatment to you if you win. You can be in for ten seconds and have 60 percent long-term gain, which I regard as, you know, extraordinary but it exists.

MR. BONDI: Do you --

MR. BUFFETT: That's -- that's all I know on gambling, next to speculation. But I do know when I see it.

MR. BONDI: My last question before I turn things over is, you've mentioned management. And people have observed that there's been failures of management at Wall Street banks. Similarly, people have ascribed there to be failures of regulators during this crisis.

MR. BUFFETT: Failures of media, failures of -- you know, Congress failures; you know, commentators, you know.

MR. BONDI: How did -- how did management fail and what do you view as the essential failures in management of the Wall Street firms? And, similarly, what would you view as the failures of the regulators leading up to and during the crisis?

MR. BUFFETT: Well, they didn't anticipate, you know, how extraordinary a bubble could be created. And it's very difficult to fault them because so few

people have a difficult time doing that. When a crowd is rushing in one direction, going the other direction is very hard.

And usually, the people that do that become discredited by the price action.

If you were a Cassandra in 2005 or '06, and houses kept going up, and after a while, people quit listening. And there incidentally a lot of the Cassandras or nuts, anyway.

They never guess anything that's going on.

So you have -- you have a fringe element to Cassandras, too.

Conceivably, you know, if a president of the United States or the chairman of the Fed or somebody made a strong statement – but Greenspan made strong statements, I remember, in 1996, you know, about irrational consumers. That didn't stop the stock market.

When people think there's easy money available, they are not -- they're not inclined to change.

Particularly if somebody said a month or two ago, "Watch out for this easy money," and then their neighbors made some more money in the ensuing month or two, it's just -- it's overwhelming. And we've seen it.

MR. BONDI: And the failures of regulators, were there any?

MR. BUFFETT: Well, there was a failure of everybody, in one sense. But the biggest failure is that they were unable to act contrary to the way humans act in these situations. I mean, you could say regulation about their screaming about the fact you people are doing foolish things. And, sure, regulators could have stopped it. If the regulators said -- or Congress could have stopped it -- Freddie and Fannie. If Freddie and Fannie had said, you know, "We will only accept mortgages with 30 percent down payments, verified income, and the payments can't be more than 30 percent of your income," you know, that would have stopped it.

But, you know, who can do that?

MR. BONDI: Do you think that if Fannie --

MR. BUFFETT: In fact, I think if you recommend that as a course of a future mortgage action, you better get an unlisted phone number.

MR. BONDI: Do you think if Fannie had tighter standards and tighter controls, that we could have averted a financial crisis?

MR. BUFFETT: Well, in fact, Freddie and Fannie were in a position. Whether they were practically in that position -- whether Congress

would -- I mean, would have tolerated them coming up with really much stricter standards, I don't think it probably could have happened.

But I'm not sure they wanted it to happen, either. I mean, they were enjoying the party, too. And they didn't think the party was going to end like this. I mean, it wasn't like somebody was thinking, "This is going to end in a paralysis of the American economy." You know, they just -- they started believing what other people believed. It's very tough to fight that.

We will have other bubbles in the future. I mean, there's no question about it.

I don't think the President of the United States could have stopped it by rhetoric. And I think any President of the United States had said, you know, "I am campaigning on a program of 30 percent down payments, verified income, and not more than 30…," they might not have impeached him, but they sure as hell wouldn't have reelected him.

MR. BONDI: Thanks.

MR. SEEFER: I'm going to primarily ask you about derivatives generally, but I want to ask you about a couple of things different first.

In your most recent shareholder letter, you talked about how Berkshire Hathaway --

MR. BUFFETT: *[Unintelligible.]*

MR. SEEFER: I hope it's not the glare.

MR. BUFFETT: Yes, *[unintelligible]* interview.

MR. SEEFER: That Berkshire Hathaway would never become dependent on the kindness of strangers --

MR. BUFFETT: Absolutely.

MR. SEEFER: -- and "too big to fail" was not a fallback position; and that the company would always have sufficient cash, apparently in the magnitude of $20 billion these days, so that that would not be a problem.

Generally, when you look at the issue of "too big fail," is it just a liquidity issue, if you have enough cash? No one's too big to fail because the issue will never come up?

MR. BUFFETT: You'll have institutions too big to fail. We still have them now. I mean, your commission reports certainly got -- I mean, Freddie and Fannie, we've totally acknowledged we've -- and incidentally they are too big to fail. I'm not quarreling with the policy on it.

They aren't too big to wipe out the shareholders, though. So it isn't -- you know, society has done the right thing with Freddie and Fannie, in my view. They wiped out the shares -- nobody's got any

illusion that the government is protecting them as an equity holder.

They do have the belief that they will be protected as debt holders, but they were sending that message well before the bubble. I mean, if Congress would say, "Technically, we aren't backing them," and they've only got this two and a quarter million, or whatever it was, line of -- but Freddie and Fannie paper was held all over the world. In a world where the other guy's got nuclear bombs and you sort of imply that the government is standing behind us, I don't think you would have wanted a default on Freddie and Fannie. So I think we've done the right thing.

But there will be institutions that are too big to fail, but they're not too big to wipe out.

The shareholders -- and I would argue that they're not too big to -- I think there should be different incentives with institutions like that, with the top management. They're not too big to send away the CEOs that caused the problem, away without a dime.

MR. SEEFER: And I understand that. I'm just asking if your opinion, is the answer to the "too big to fail" problem, make them hold more cash?

MR. BUFFETT: That -- the answer is -- and it isn't a perfect answer -- you will always have

institutions too big to fail, and sometimes they will fail in the next hundred years.

But you will have fewer failures if the person on top, and the board of directors who select that person and who set the terms of his or her employment, if they have a lot to lose.

And in this particular instance, the shareholders have gotten -- they probably -- it's well over half a trillion, and it may be approaching a trillion -- they've suffered the losses, society has suffered the losses from all the disruptions that are setting in place. Directors and the CEO.

The CEOs, you know, they only have 80 percent of what he had before, but they're all well, wealthy, beyond the dream of most Americans. The directors, you know, have collected their $200,000 or $300,000 a year, and they're projected by *[unintelligible]* insurance.

And so the people that are in a position to make decisions day-by-day as to trading off the safety of the institution versus the chance for improving quarterly earnings or something of the sort, they need different incentives, in my view; and so far, nothing has been done on that.

MR. SEEFER: So let me ask you, because, obviously, another area we look at is a potential

contributing cause of the financial crisis are compensation structures and incentive structures within firms.

And you have seen a lot of firms, you know, come out since the crisis and say, "Oh, well, now we're doing things differently. Now, we pay more of our executives in stock. Now, the stock or cash bonuses are subject to claw-back provisions and vesting periods," or whatever.

Do you have any thoughts on what -- how you do make them have accountability for when things go wrong?

MR. BUFFETT: All of that is good. I mean, that's better than what existed before. But I think it has to be far more draconian than that to really change behavior big time.

The difference is, between the guy making a hundred million dollars and $50 million, you know, that -- or clawing back $25 million on the front, you know, sure, it registers, but it doesn't -- I don't think it changes behavior that much compared to at least what I would have in mind.

MR. SEEFER: Do you -- and that's the next thing, I was going to ask you, what are the more draconian --

MR. BUFFETT: I think it's enormously

important, when you get very big financial institutions -- and maybe in other cases, too -- well, we're in a building run by the Kiewit Company, it's the most successful construction company in the world. I mean, it has been for decades. Nobody has ever heard of it, but it's huge. And it's got a set of management principles. And basically, it started with Pete Kiewit *[phonetic],* saying that arranging a compensation system so that if the company got in trouble, not only he went broke, but all the people who got him in trouble went broke.

And when you have the ability to do things with government-guaranteed money, as in banks or something -- or Freddie and Fannie, whatever it may be -- you need a person at the top who has all of the downside that somebody has that loses their job, you know, working in an auto factory or something of that sort. And that will change behavior.

Now, you can argue, it may make them too cautious. So you want some upside for them, too. I mean, you want them to balance somehow their interest in a way that society might balance its interest.

And as part of that with a CEO, you need important but far less draconian arrangements in terms of directors, because they -- they can't -- they can't

evaluate risk in a large institution or risk committees telling them what's going on, but they can set the terms of employment for the CEO in a way that will make him terribly risk-conscious. And if they don't do that, they haven't done it effectively, I think there should be a significant downside to that.

I've suggested to them that maybe they give back, you know, five times the highest compensation they received in the previous five years or something. It has to be meaningful, but it can't be so draconian, that you don't get directors.

You'll get CEOs. You have to worry about that. You have a lot of upside for CEOs, you can give them the downside of, you know, sack cloth and hot ashes, and you'll still get CEOs.

MR. SEEFER: The downside, of course, is just zero, you can file bankruptcy, and that's it.

I've got a question for you, though, related to that. In the 50 years-plus that you've been investing, have you seen changes in compensation approaches, policies, attitudes with respect to senior management at these various *[unintelligible]* --

MR. BUFFETT: Well, it's gradually. Maybe not -- yes, it's changed over the years, and you've seen it just in the relationship of top management

compensation to the average employee. So it has gotten considerably more generous, if you want to use that term, from 50 years ago.

There used to be a few outstanding -- Bethlehem Steel was famous for paying a lot of money, if you go way, way back and all that. But, in general, it wasn't expected.

And there's some ironic aspects to that because, in a sense, the SEC is required has required more disclose about pay packages and everything like that. So you've got this envy factor. I mean, the same thing that happens in baseball. I mean, if you bat .320, you expect to get more than .310. And nobody knows, in business, whether you batting .320 or not, so everybody says they're a .320 hitter, and the board of directors has to say, "We've got a .320 hitter," because they couldn't be responsible for picking a guy that bats .250.

So you have this ratcheting effect, which I've talked about a lot of times.

And the more information that's published about compensation in a way, the worse it's gotten in terms of what people do because they look at the other guy, and he's got personal use of the play *[unintelligible]* whatever that may be and that gets

built into the next contract. So it's changed over the years.

And the downside has not paralleled the upside in terms of innovation.

MR. SEEFER: Well, let me ask you, other than looking at perhaps more draconian measures for money and compensation that is received, do you have any opinions on just the amounts that are paid, in whatever form, in the first place? And, for example, one of the things we see -- and, frankly, I saw this before I came to the FCIC -- is you always read in a policy statement that all these companies go out and higher somebody to do a survey and see -- you know, to come up with executive compensation, and they're looking at a bunch of companies that pay their executives a lot of money, and they say, "Okay, you should get a whole lot of money, too."

MR. BUFFETT: Ratchet, Ratchet, and Ratchet, that's the name of the comp firms.

MR. SEEFER: Right. And do you have any opinions on just the level of the executive compensation?

MR. BUFFETT: Well, it's perfectly understandable. I mean, you've got a CEO that cares enormously about his compensation. You've got a

compensation committee that meets for a few hours maybe, you know, every meeting. You've got a human relations vice president who is working for the CEO that probably suggests a compensation consultant -- a compensation consultant who is draconian is not going to get hired generally around, or even too innovative on the downside. There's just…

So it's the agency problem that the economist would call it. But it's very -- it's very hard over time -- and then you've got this comparison factor which embodies all these other things I just mentioned, and then they get into the system, and people say, "Well, we didn't hire -- we didn't hire a guy on the bottom quartile to be our CEO so we're not going compare to the bottom quartile and we're not going to compare to the next-to-the-bottom quartile." So it just ratchets up, and we've seen it.

And I am the comp committee for seventy-some companies which Berkshire owns. It's not rocket science. And we pay a lot of money to some of our CEOs, but it's all performance. When they make a lot of money, it's performance-related.

And we have different arrangements for different people; but we've never hired a compensation consultant, ever, and we never will.

I mean, if I don't know enough to figure out the compensation of these people, you know, somebody else should be in my job. And the thrust is how do they perform and do they leave for other places; and, you know, we've got the record on that.

The problem -- you know, I'm in a position to control; I am the stockholder of these subsidiary companies. And when you get people in between who are getting paid, you know, $200,000 to $300,000 a year for being on board, which is important to some of them, and where they're hoping that they get put on some other board so they get another $200,000 or $300,000 a year, they are not exactly going to be Dobermen pinschers, you know, in terms of policing things.

MR. SEEFER: In terms of -- we've seen Bear fail, Lehman fail, Merrill essentially fail and get acquired of BofA, and Morgan Stanley and Goldman both received government assistance, and Goldman received the benefit of your investment, too.

All of those investment banking franchises, I believe that the compensation structure was essentially minimum, 45 percent, and net revenues was getting paid out in comp, some years even higher.

Any opinion on that structure?

MR. BUFFETT: I can tell you it's very hard to

change. I was at Solomon. And it -- the nature of Wall Street is that, overall, it makes a lot of money relative to the number of people involved, relative to the IQ of the people involved, and relative to the energy expended.

They work hard, they're bright, but they aren't -- they don't work that much harder or that much brighter than somebody that, you know, is building a dam some place, or a whole lot of other jobs.

But in a market system, it pays off very, very big, you know. And in effect, you know, boxing pays off very big now compared to what it did when the only auditorium you had was 25,000 seats at Madison Square Garden. And now you've got cable television, and so you can put a couple of, you know, lightweights who you'll never hear of again out on Pay-Per-View, and they'll get millions for it now.

Market systems produce strange results and Wall Street -- in general, the capital markets are so big, there is so which money, that taking a small percentage results in a huge amount of money per capita in terms of the people that work in it. And they're not inclined to give it up.

MR. SEEFER: And when you see the general compensation structure, in terms of percent pay-out and

the types of structures they have with ever differing levels of draconian claw-backs and whatever, and the risks that were taken that resulted in failures and bail-outs, I mean, do you see, in the big -- you know, the compensation picture, in general, as a contributing cause to part of the story of what happened on the street?

MR. BUFFETT: Comp -- most of the comp -- you're talking about individual traders on, you know. And they have the big -- you know, they call it the "traders' option." But they've got the upside. If they have a good year, if they have a bad year, you know, they might have a good year again next year. They might go to another firm. But they really -- their interests are not totally aligned with shareholders.

And I would say this: I think most managements of Wall Street firms -- and I was around Solomon, I know what happens, they're trying to -- they want to align them. I mean, it isn't -- it isn't like the top management is oblivious to this problem.

But I can just tell you, being at Solomon personally, it's just -- it's a real problem because the fellow can go next door or he can set up a hedge fund, or whatever it may be.

You don't -- you don't have a good way of

having some guy that produces X-dollars of revenues, to give him 10 percent of X, because he'll figure out, he may find some other place that will give him 20 percent of X or whatever it may be. It is a tough managerial problem.

But I think the best thing, again, if you're worrying about the Bear Stearnses of the world is to have an arrangement in place so that if they ever have to go to the federal government for help, that the CEO and his spouse come away with nothing. And I think that can be done, you know.

And I think if society is required to step in and, you know, come up with all kinds of things -- disrupt, you know, the lives of millions of Americans in various ways, I think that there ought to be a lot of downside. And I think that would change behavior more than any -- *[unintelligible]* write some terribly complicated thing, you know, only 38 percent revenues. I just don't know how to write rules, otherwise.

This would get their attention. And I wouldn't try to try -- I wouldn't know how to get more specific than that.

MR. SEEFER: Well, then let me ask you this then: If the CEOs and their spouse --

MR. BUFFETT: Yes.

MR. SEEFER: -- unlucky marriage there -- you know, have to give back every penny --

MR. BUFFETT: Maybe the spouse would do better policing than the regulator.

MR. SEEFER: You know, if they need to give everything back or be shown the door, if the company needs government assistance, there's CEOs at some firms that got government assistance that are still there, including, for example, Mr. Blankfein, that I've at least read, you said, "Boy, if they were going to replace Blankfein, I'd like to replace him with his brother."

MR. BUFFETT: Yes. I don't think they needed assistance. The system needed assistance then. But if, when they had that famous meeting at the Treasury on Monday, if they hadn't called on Goldman Sachs and they called on the others, Goldman would have been fine. The system needed to be supportive.

It wasn't as important as precise action here; it was that the world had to see that the federal government was going to do whatever it took. And nobody knew what "whatever it took" meant, but they did need to see conviction and action and all of that.

And Bernanke and Paulson, they could have called on nine different other institutions. These were

particularly good names to have there.

But -- and gone through the same mechanism, and Goldman Sachs would have been fine. Wells Fargo would have been fine. They didn't need the money. The system needed the reinsurance that the government was going to act.

MR. SEEFER: When -- it's been reported, when you made the investment in Goldman in September of '08, that you were, you know, at least somewhat betting on the government taking some type of action.

MR. BUFFETT: Not in relation to Goldman, though. But I was betting on the fact the federal government would show the will to the American people that they would, in effect, do whatever it took to restart the engine.

MR. SEEFER: So I don't know if you can answer this question because it's somewhat of a hypothetical; but if you knew then that the government was not going to put any money into Goldman, would you have still made the investment?

MR. BUFFETT: I'd have -- well, oh, yes, it *[unintelligible]* what I put in Goldman.

But if I thought the government was not going to reassure the American public through acts, speeches, whatever it might be, that they were going to do

whatever it took to save the system, then I would have, you know, got my mattress out.

But the -- but Goldman did not need the money; the system needed the reinsurance, but Goldman would have been -- if they'd never been called down there, they would have been fine.

I wouldn't have put the money in, if I thought Goldman needed specific government action. But I also would not have put the money in if I thought the government was going to stand by and watch things unfold.

MR. SEEFER: Right, right, okay.

So, now, let's actually turn to derivatives. I didn't think we'd spend that much time.

MR. BUFFETT: Uh-huh.

MR. SEEFER: We are -- the statute, amongst other things, tells us to look at the role of derivatives that it played in the financial crisis. And we have been talking to many, you know, quote, unquote, experts in the field, whether they're academicians or market participants that work with derivatives.

And, of course, we've read, you know, what you've written in the shareholder letters, that were weapons of mass destruction, they can lead to excess risk and leverage, and there's counterparty risk. At

the same time, if they're managed effectively, they can be fine; although, I think in your shareholder letters, you're primarily talking about credit derivatives there, but I may be mistaken.

MR. BUFFETT: Well, and let me -- Burlington Northern, they're hedging diesel fuel. Now, what I tell them is, I wouldn't do it if I were them, but it's entirely up to them. I mean, diesel fuel is a big cost for them, and they've got pass-through clauses with some of the people that use the railroad and they don't have pass-through. So they're exposed, partly.

The only reason -- I tell them, if they really don't want our diesel fuel in the market, we'll just close up the railroad, and make alternate diesel fuel all day. If they don't know it, they're going to be out the frictional costs over time.

The reason many of them do it, is that they want -- the public companies -- is that they want a smooth earnings. And I'm not saying there's anything wrong with that, but that is the motivation. They don't -- they're not going to -- they're going to lose as much of the diesel fuel contracts over time as they make; but they can protect themselves just like Coca-Cola does on the foreign exchange -- and they make a big thing of this.

I wouldn't do it. They do. But all kinds of -- most companies want to do that. Anheuser-Busch was just talking about it in *Business Week* a few weeks ago how they do it. It's a common practice. It's overdone, in my view, but it is a response to the fact that the market doesn't like the fact that diesel fuel could affect the earnings of Burlington or Union Pacific up and down some quarter when, really over time, they're not going to make any -- they're not going to save any money by doing it, in my view.

MR. SEEFER: And just broadly, whether it's interest, foreign exchange, commodity equities or credit derivatives, do you have a view on whether they contributed or caused the financial crisis? What role they played, whether it was a cause, a contributing cause, a propagating mechanism, or anything?

MR. BUFFETT: Anything that increased leverage significantly tends to make -- it can't even create a crisis, but it would tend to accentuate any crisis that occurs.

I think you that if Lehman had been less leveraged, there would have been less problem in the way of problems. And part of that leverage arose from the use of derivatives, and part of the -- part of the dislocation that took place afterwards arose from that.

And there’s some interesting material, if you look at -- if you look at -- I don’t know exactly what Lehman material I was looking at -- but they had a netting arrangement with the Bank of America, as I remember. And, you know, the day before they went broke -- and just are very, very, very rough figures, from memory -- but as I remember, the day before they went broke, Bank of America was in a minus position of $600 million, or something like that, they had deposited with, I think, JPMorgan in relation to Lehman.

And I think the day they went broke, it reversed to a billion and a half in the other direction. And those are big numbers. And I think the numbers -- I think I’m right on just order of magnitude.

So when things like that exist in the system, you know, it’s under stress for other reasons, it becomes a magnifying factor how big of a one, you don’t know.

But Lehman -- Lehman would have had less impact on the system if they had not had the derivative book that they had. Now, they probably had bad real estate investments and a whole bunch of other things as well.

MR. SEEFER: Now, when you talk about the leverage and the counterparty risk from derivatives, are

you talking about certain types of derivatives? You know, there's the five categories we see. Do you have any opinion on --

MR. BUFFETT: Unfortunately -- yes, unfortunately people have gotten very imaginative about derivatives. I mean, it started out with the simple ones and, you know, interest-rate swaps and that sort of thing, and foreign currency. And then the profit got driven away from those.

When I was at Solomon, they talked about it, how the plain vanilla context of there wasn't money in it anymore because they were on the screens and everybody *[unintelligible]*…

But what they call it sometimes, the toxic waste, there was a lot of money in. And the more complicated a derivative was -- well, you remember the situation with the Proctor & Gamble thing from Bankers Trust and American Greetings and all of that? If you read the nature of those contracts, where they have these exploding factors, you know, when you got beyond a certain point under it, the CFO of a place like Proctor & Gamble or American Greetings was probably not understanding those things very well. And there's just more money in contracts that people don't understand. And so you get this proliferation of these things.

And who knows what's in the mind of the end user that thinks they're, you know, protecting themselves against this or that, like Jefferson County in Alabama, and all kinds of things.

So it's -- it's an instrument that is prone to lots of mischief, because of long settlement periods, complicated formulas for sometimes deriving the variables that entering into the eventual payoff, it's got a lot of possibilities for mischief, and a lot's been caused.

And mischief doesn't make much difference if it's, you know, one guy, you know, rolling dice against another or something and one guy's loaded the dice for $5 a throw. But it makes a lot of difference when you get into big numbers.

MR. SEEFER: So let me -- let me ask you on the issue of transparency. You wrote in your shareholder letter -- not the recent one, but the one from the year before -- that it's simply impossible for investors to understand and analyze these; it was impossible, or at least very difficult, for auditors to audit them, and for regulators to regulate them; and that, after spending time with financial institutions, 10-K or whatever else, you reached for a bottle of aspirin, which I can very much appreciate --

MR. BUFFETT: I'll send you a case

MR. SEEFER: -- from of the 10-Ks we've seen.

And you also wrote that, you know, policymakers talk about transparency as being a great cure-all for --

MR. BUFFETT: It's a great word.

MR. SEEFER: -- these kinds of problems.

MR. BUFFETT: Nobody can be against transparency.

MR. SEEFER: Right. You said, you know, "Look, I don't know of any reporting system, how they can fix this."

I mean, obviously, we're -- you know, just looking at causes of the financial crisis, but this whole lack of transparency, particularly in the area of derivatives, as you know from taking aspirin for your headaches after looking at 10-K's, is a problem.

So I'm just wondering, you know, what your opinions are on how do we address that problem?

MR. BUFFETT: I think it's a terribly difficult problem because -- well, it was so difficult a problem, I didn't think I could solve it.

We bought Gen Re, which had 23,000 derivative contracts.

I could have hired 15 of the smartest

people -- math majors, Ph.D.s, and I could have given them carte blanche to devise any reporting system to me, that would enable me to get my mind around what exposures I had, and it wouldn't have worked. The only answer was to get out of it.

Can you imagine, 23,000 contracts with 900 institutions all over the world, probably 200 of them with names I can't pronounce, you know? And all of these contracts extending years in the future, multiple variables. You know, all of these -- you can't -- you can't manage them, in my view. You know, I wouldn't be able to manage something like that.

And if I read a 10-K that's 300 pages long and it describes notional values and all this -- not to impugn anybody because probably one of the best-managed, really large institutions around -- but if I look at JPMorgan, I see two trillion of receivables, two trillion of payables, a trillion seven netted off on each side; of the 300 billion remaining, maybe 200 billion collateralized.

But -- that's all fine, but I don't know what these continuities are going to do to those numbers overnight. If there's a major nuclear, chemical, or biological terrorist action that really is disruptive of the whole financial system here, who the hell knows what

happens to those numbers on both sides or thousands of counterparties around?

So I don't think it's -- I think it's virtually unmanageable. It certainly is -- it would be for me.

MR. SEEFER: And ask let me ask, I mean, Goldman's the K I looked at recently --

MR. BUFFETT: Uh-huh.

MR. SEEFER: -- in there I see over a million contracts.

MR. BUFFETT: Over a million contracts? I thought it 700,000 or 800,000.

MR. SEEFER: They don't disclose notional values in the K -- at least not that I found yet; but, you know, they do disclose, when you take out the netting, that it's about one and a half trillion dollars, both assets and liabilities.

You go to BIS and get information from Goldman that's not in their 10-K, it's like 45 trillion, when you add up all the numbers.

MR. BUFFETT: It's bigger than JPMorgan.

MR. SEEFER: So -- and I don't see anything in the K's -- and there is a question coming, I promise -- on who the counterparties are.

I mean, does -- would that help in

transparencies --

MR. BUFFETT: No.

MR. SEEFER: -- so more disclosure? I mean, who the counterparties are?

MR. BUFFETT: You can't design a system, I don't believe.

I mean, I couldn't design a system, and I've got a smart partner, Charlie Munger; and we -- the two of us couldn't design a system -- or come close to designing a system -- that would have told us what we were doing, so we got out.

And we do know what we're doing with the 250 contracts we've got. And, frankly, I think we do a better job of disclosure of our derivatives position than any company in the United States. You know, we just tell people what we've done.

But that's easy to do with 250 contracts, or thereabouts, and they only fall into a couple of categories.

But I want to know -- I want to know every contract. And I can do that, with the way we've done it; but I can't do it with 23,000 that a bunch of traders are putting on.

I'm putting these on myself; and there are really only about two or three decisions that go through

my mind in doing that.

But to have a group of traders putting on thousands of them, and counting on the behavior of Party A over here to be the offset to what might happen with Party C, you know, and I'm in between, I just -- I don't know to do that. And I don't think anybody really knows how to do that.

And I probably shouldn't talk about names on this. But I've had discussions with very important people about this in the past, before the crisis hit; and those people were confident that risk committees would come in with spreadsheets and explain it all. And I always felt that was total nonsense.

MR. SEEFER: There has at least been some recent reports in the press, that you've been lobbying against the retroactive adjustment, or representative active effect, or at least some provisions and legislation that would require collateral to be --

MR. BUFFETT: Yes, we're not against collateral being required at all, as far as -- we do say, if you're changing contracts retroactively, that if a change in any part of the contract is made, that the party benefiting from that change should pay the appropriate amount to the party that's suffering from it.

Now, when we put on, in our contracts -- because we didn't want to get ourselves in a position where we were a problem to the country -- we negotiated for non-collateral-type contracts.

Now, the price of collateralized contracts, we would have received considerably more in the way of premiums if we had agreed to collateral.

Right now, we're looking at one contract where we can get paid $11 million if we agree to put up collateral and we can get paid 7 and a half million dollars if we'd only agree to put up collateral. Every other term of the contract is the same.

So all we say is that if these things are changed retroactively, we want to be paid for the difference in value between a collateralized contract, not a collateralized contract.

And otherwise, incidentally, it isn't just us; Coca-Cola, Anheuser-Bush, you name it, will have to send money to Wall Street as part of a deal that would be changed from before.

And there's nothing wrong with that if it's a matter of public policy that they want all contracts collateralized, including changing them retroactively.

There may be a constitutional problem, I'm not sure about that.

But if the difference was paid for the difference between the value of collateral as a contract, we were offered $150 million on -- during the height of the crisis on just a relatively small piece of it if we would accept -- if we would change it from a collateralized -- non-collateralized contract to a collateralized contract by a big Wall Street firm, and we just say, if that's forced upon us to do that, 150 million or whatever the appropriate number is -- we sold a house, in effect, that was unfurnished; and if we had sold it furnished, we would have got more money. And if the government says now, later on, two years after we made the deal, "You've got to give the furniture, too," we want to get paid. And I think that would probably stand up in court, incidentally. I mean, it wasn't even addressed in the in the bill. But we'll see what happens on it.

MR. SEEFER: Sure.

Other things we've heard from other folks that I'll ask your opinion on.

A lot of people seem to think that a lot of the over-the-counter derivatives are pretty standardized contracts that should be traded on an exchange.

Any opinions on that?

MR. BUFFETT: Well, I think it's very hard to

do. I mean, you've got, right now, certain foreign exchange contracts that are trading on exchanges.

The volume was practically nothing, because they're -- let's just take a Swiss franc contract. There's a September contract and a December contract and a March contract. But if we want to hedge some instrument, we've got -- and we've done this with a few contracts -- we want to hedge some contracts that are due December 16th, we probably want to have a contract -- a forward contract expires December 16th.

And so whereas it's easy to have -- and I don't know whether July corn or October corn, or whatever it may be, there's not a big delivery -- there's not a big tailoring of the specific industry's requirements.

You can get away with four different expiration dates. With S & P, you get away with four expiration dates or something. But if you've got a power contract or something of the sort, a contract to deliver electricity on July 15th, and you're worried about what you might have to buy in an emergent market to do it, you're probably going to need one that a contract is July 15th. And I don't know how you standardize -- I mean, it's very easy to have standardized October copper and oil. I mean, you know,

you've got all contracts extending out for many years, or natural gas. But they are just periodic settlement dates.

And I think that gets -- it's gets very tough with a great many derivative contracts.

But I don't -- I'm no expert on how all this works. I mean, there may be ways of solving that in terms of exchanges.

MR. SEEFER: But let me ask you about regulation. I mean, one of the things that we know from doing some research is, of course, back in the beginning of the decade -- or the beginning of it, 2000 -- was the Commodities Futures Modernization Act, that had terms in it that said, "You can't regulate credit derivatives," so they wanted it unregulated.

Any opinions on regulation of credit derivatives or derivatives in general?

MR. BUFFETT: I think it's very tough to do. But I will tell you that whenever I hear the terms "modernization" or "innovation" in financial markets, I reach for my wallet. It -- it's usually -- what they mean is revenue-producing.

And I think it's very tough. I mean, that's what I got into, in my letter in 1982. I mean, you are opening Pandora's box when you give people the right to

either invest, speculate, or gamble on very long-term contracts, you know, with minimal margin requirements. I mean, it can pose dangers to the system.

But it gets down to leverage overall. I mean, if you don't have leverage, you don't get in trouble. That's the only way a smart person can go broke, basically. And I've always said, "If you're smart, you don't need it; and if you're dumb, you shouldn't be using it."

So I'm not a big fan of leverage. But leverage and incentives are, in my view, things to try to focus on, and recognizing that there's a lot of limitations on what you can do.

But I mean, we've always felt that way with banks. A bank has the right to use government-guaranteed money, in effect. I mean, you've got to have some limitations on leverage. So then they come up with SIVs and derivatives, and all kinds of ways to increase leverage without breaking the rules. And it's a tough question, but I would be fairly tough about how I would go at that.

And I don't like to keep going back to it, but it doesn't seem to be anything talked about. But the CEO is the guy making the decision. I'm making these decisions for Berkshire. When I make the decisions at

Berkshire, I'm thinking about the fact, A, I've got 99 percent of my net worth in it, it's all going to charity, so I'm -- I mean, if I cause this place to go broke, there is a lot of downside to me, and there's a lot of downside to the Kiewit Company if they do silly things in their construction business. And I think the downside has an effect on people.

MR. SEEFER: Well, do you think that -- I mean, you keep coming back to the CEO and accountability for perhaps unreasonable risks they are taking.

Should that -- is that an area that you think regulation should address?

MR. BUFFETT: Yes, I think -- I've never written a bill in my life, so I don't know how you do that. But I do think that if I were in charge, I would have some -- yes, I would -- it wouldn't have to be very complicated. I mean, we're not talking about some small community bank here; we're talking about institutions that require government intervention.

The FDIC will take care of the small banks and all that. And a lot of those will be a lot of personal ownership, anyway.

But the FDIC is not the federal government. I mean, that is banks paying for banks' errors.

But when society -- the U.S. government starts

paying for specific errors, then I think there ought to be a lot of downside.

MR. BONDI: Can I follow up on that?

You mentioned small banks and community banks. We've read stories and certainly heard reports about community banks investing in CDOs, investing in --

MR. BUFFETT: They bought -- they bought a lot of Freddie and Fannie preferreds. There was a lot of money lost in that then.

MR. BONDI: Correct, correct.

But with respect to CDOs -- and many of them bought what were rated as AAA tranches of CDOs. Over 90 percent of the ratings on CDOs have been downgraded to near or around junk status.

How much -- putting aside legal responsibility because credit-rating agencies have asserted they have a First Amendment right -- how much, though, responsibility, in the moral sense or otherwise, do credit-rating agencies have for the decisions by the investment community to rely on their ratings, that AAA meant AAA? How much responsibility do you think that the credit-rating agencies have for these decisions that the community banks made, and subsequently made to their demise?

MR. BUFFETT: If you're a banker, your job is

to assess the credit of whatever you're committing to. And the interesting thing about those CDOs, a lot of them consisted of hybrid bank securities. I mean, so they were actually benefiting -- there were a lot of hybrid bank securities put into CDOs, and they were benefiting from raising money from that form, but -- and that turned out to be a way poorer asset than they thought. But they created the liability, to some degree, as a group.

But I would get back to the fact that if you run a bank, you know, I think your job is to assess the credit of when you lay out money, whether you're buying U.S. Treasuries, whether you're buying bonds of Greece, whether you're buying -- lending money for construction.

And I think that -- I think -- I would not want the cop-out, really, of "I was relying on a rating agency."

And the rating agencies, they have models, and we all have models in our mind, you know, when we're investing. But they've got them all worked out, with a lot of -- a lot of checklists and all of that sort of thing.

I don't believe in those, myself.

All I can say is, I've got a model in my mind. Everybody has a model in their mind when they're making

investments.

But reliance on models, you know, work 98 percent of the time, but it's -- they never work 100 percent of the time. And everybody ought to realize that, that's using them.

MR. BONDI: Uh-huh.

You mentioned transparency earlier as well. These CDO instruments were largely opaque in terms of compositions and the like to the investors, who were investing in them. They were structured and created, though, around the ratings, and in connection with the ratings and the rating agencies.

Do you think, though, that because of the opaqueness of these instruments, ratings became, in the minds of the investors, more important than perhaps maybe they should have been?

MR. BUFFETT: Well, I would say that, you know, anybody that's investing in something they consider opaque should just walk away, I mean, whether it's a common stock or -- you know, or a new invention or whatever it may be.

That's why Graham wrote books, to try to get people to invest -- take that investment. It's very tough to get that message across.

You would think bankers, however, would --

would have learned by the time they get to run a bank.

MR. BONDI: Sorry, Chris.

MR. SEEFER: Okay, lots move away from derivatives now and talk about -- I mean, you talked about several areas already today about your views on causes, or contributing causes to the financial crisis. Of course, we have a statute with a gazillion things in there, telling us to investigate. And I know time is probably starting to run short; so I'd like to first just ask you, you know, what haven't you told us in terms of you think were important contributing causes to the crisis? And then I'm going to try to go quickly down the list in our statute and get your ideas on those --

MR. BUFFETT: Well, I think the primary cause was an almost universal belief, among everybody -- and I don't ascribe particular blame to any part of it – whether it's Congress, media, regulators, homeowners, mortgage bankers, Wall Street -- everybody -- that houses prices would go up. And you apply that to a $22 trillion asset class, that's leveraged up, in many cases. And when that goes wrong, you're going to have all kinds of consequences. And it's going to hit not only the people that did the unsound things, but to some extent the people that did the semi-sound, and then

finally the sound things, even, if it is allowed to gather enough momentum of its own on the downside, the same kind of momentum it had on the upside.

I think contributing to that -- or causing the bubble to pop even louder, and maybe even to blow it up some, was improper incentives -- systems and leverage. I mean, those -- but they will contribute to almost any bubble that you have, you know, whether it's the Internet or anything else.

The incentive systems during the Internet, you know, were terrible. I mean, you just -- you formed a company, and you said, "I'm going to somehow deliver a billion eyeballs," and somebody says, "Well, that's $50 apiece," or something. I mean, you get craziness that goes on there.

Leverage was not as much a factor in a bubble. But I think in this particular bubble, because leverage is so much a part of real estate, that once you loosened up on that, you've provided fuel that caused that bubble to get even bigger, and you made the pop even bigger, when it finally did pop.

MR. SEEFER: Uh-huh. Any views on the role of fraud, whether mortgage fraud or other types of fraud in the crisis?

MR. BUFFETT: Well, I mean, there was,

obviously, a lot of fraud. There was fraud on the parts of the borrowers and there was frauds on the part of the intermediaries, in some cases.

But you'd better not have a system that is dependent on the absence of fraud. I mean, it will be with us.

MR. SEEFER: What about -- you know, another thing that I think we've seen in the last ten years was different, was a lot of financial institutions, before, used to originate loans, and, you know, how novel, carry them on their books.

But now, we see the proliferation of mortgage brokers, originate-to-distribute models, the street packages and securitizes, sends it off to someone else, who maybe either keeps it or throws it in a CDO, or so on and so on.

Any opinions on that relative change in the way that mortgage assets are originated now?

MR. BUFFETT: People will be more careful with their own money than with other people's money.

And you can argue that Freddie and Fannie were the ones that -- you know, they started securitizing, in effect. Huge, white people used to buying mortgage instruments where they were very divorced from the origination of it. So there is no question that if

there had been a law against laying off mortgages for somebody else, that you wouldn't have the same situation.

You might not have had as much -- a lot of good things that happened in the country, too, though.

Balancing the two, I'm not sure I could -- I could do. But I can tell you that more mischief will occur if somebody in Norway is buying a mortgage in Omaha, than if some guy here is lending his own money.

MR. SEEFER: There certainly appeared to be a loosening of underwriting standards, and certainly an increase in what we've termed, you know, "non-traditional mortgage product," whether it's lower down payments, whether it's the liar loans, stated income loans, whether it's, you know, option ARMs, whether it's --

MR. BUFFETT: Everything.

MR. SEEFER: -- 2/28's, 3/27's, et cetera, et cetera.

Any views on whether that had any --

MR. BUFFETT: Oh, it had plenty to do with it. I mean, it fueled the -- it fueled extreme leverage, and it fueled leverage that could only be paid out of the resale of the asset rather than the income of the borrower.

Once you -- once you start lending money, big time, to people where your hope of getting your money back is that the asset goes up rather than the asset produces enough to service the loan, I mean, that's very dangerous, whether it's farmland, whether it was oil in Texas. It creates a lot of problems.

MR. SEEFER: Any views on why we saw the growth in that kind of non-traditional mortgage product?

MR. BUFFETT: We believed that houses were going to go up.

Once you think the asset will go up, you don't have to look to anything else. And it became -- because it had been going up, an awful lot of people believed it had to keep going up. I mean, it gets back to the nature of bubbles.

MR. BONDI: Uh-huh. We've -- I mean, from people we've talked to and articles we've read, I mean, where people talk about -- we've read, there was a lot of money coming into the U.S., chasing yield. There was the street wanting it because of the change from Finehold *[phonetic]* to the original industry, you know, securitization model. Were Fannie and Freddie, you know, changing their purchasing patterns and increasing demand for non-traditional mortgage product, for whatever reasons.

Any comments on any of those possibilities or --

MR. BUFFETT: Well, a market system creates incentives to do more business. I mean, that is the nature of it.

But I -- you know, when people talk about excess funds around the world and all that, I tend to discount that sort of thing. But I don't discount the incentives of everybody in the American public from wanting to do a piece of business if they can do it tomorrow.

It doesn't mean they're terrible people or anything. But, you know, if I'm a realtor and I've seen a house go from 250,000 to 500,000, do I say to the person now, just buying the house at 500,000, "I really think this is kind of dumb because it's only 250,000." It just doesn't happen.

They say, you know, "You'd better do it today because there's going to be more tomorrow."

And so everybody gets into the act. It doesn't mean they're evil people. There are some crooks in the process. But overall what happened was not caused by the crooks. It may have caused the crooks to get rich, and a lot of -- but it, in my view, was caused by a mass delusion.

MR. BONDI: Throughout the nineties and the 2000's, members of Congress, members of the Administration were all encouraging homeownership.

MR. BUFFETT: Sure.

MR. BONDI: Both through statements, through plans and policies.

How much of that do you think contributed to the bubble?

MR. BUFFETT: It all contributes.

But the truth is, I've told the people, you know, home is a good investment, particularly -- you know, it's got values beyond what it will do in terms of possible appreciation over time.

It really is a way to go short the dollar, I mean, if you borrow a fair amount of money against -- and most people don't have a good way of being short to dollar, and it's a pretty sound policy to be short dollars as long as your carrying costs aren't too high; and when interest rates get low, the carrying costs are not high.

So it is not an unintelligent thing to do. It's only -- it's only when it gets into this bubble aspect that it becomes unintelligent.

But I would recommend today, you know, if a couple can afford it and you're not paying silly prices

in terms of replacement value or anything like that, if you want to buy a home in Omaha, I would say, you know, if you find the neighborhood you want and your family's going to live there -- you know, right now, I think mortgage rates are very attractive, I would say, "Buy it," you know.

But I wouldn't say, "Buy three more on speculation," and I wouldn't say, "Buy it if it's going to take 50 percent of your income to service the mortgage."

It's a sound idea that went crazy.

MR. BONDI: Should it be a government policy then to encourage homeownership?

MR. BUFFETT: Well, I think it's -- I don't -- I would say it should be a government policy. And we've got Fannie and Freddie. I mean, we say -- we're in the mortgage business as a country.

To help people who are following sound practices that want to buy it, I do not see anything wrong with having a government guaranteed program that kicks in when people really have a 20 percent down payment, really are only putting 30 percent or so of their income into it. Still, people are going to lose their homes for unemployment reasons, and death and divorce and disability -- I mean, the 3 D's. But that's

not going to cause a systemic problem.

And more people are going to benefit from that program, by far, than anybody that's going to be hurt by it. So I think that the government has a place in that. And around the world, it has a place in it.

But I don't think that if you're going to get 20 percent down payments, that you should then take deals on with 3 percent down payments and then lay off that on some mortgage insurer or something like that. You don't want to encourage people to do things that are going to cause them pain later on.

And you're going to have occasional pain from unemployment. But you know what? You don't want systemwide pain because you've been encouraged them to do things that are stupid.

MR. SEEFER: One of the areas in our statute is the role of monetary policy. And, of course, a lot of folks have commented on the low level of interest rates throughout the 2000's.

Any view on that as a contributing cause?

MR. BUFFETT: Well, it makes it obvious, it makes it easier. But, no, I don't think that was what caused this.

You couldn't have had it if you had 15 percent rates, obviously. But it all -- it all worked together,

you know. And finally, the fact that houses kept going up a lot. It just -- it put a model in people's mind. You have 300 million Americans who have got an economic model in their mind, and you would say, you know, "Moody's is dumb for having it and the S & P is dumb for having it" -- but it was pervasive.

MR. SEEFER: Another area in the statute that we're directed to go look at, and that we have been looking at, of course, is the role of accounting, and specifically mark-to-market rules on accounting.

I know you wrote in your shareholder letter -- letters, that the mark-to-market accounting rules result in wild swings in your derivative accounting but that you and Mr. Munger -- it is what it is --

MR. BUFFETT: We'll explain it. Our job is to explain it.

MR. SEEFER: Right. But other people we've talked to, and articles we've read have talked about the mark-to-market accounting rules, if nothing else, perhaps fueling the downward spiral, you know, in the '07 and '08 time frame, when folks got into liquidity crunches and had to sell assets, et cetera.

Any views on the role of accounting, mark-to-market accounting in the *unintelligible]* --

MR. BUFFETT: I'm less religious about it than

I used to be. Because, well, after '29, in the insurance business, they put in so-called -- I forget, they had a term for it, but I think it was called -- it was basically commission or evaluations of some sort; and they did not make insurance companies write their stuff down because they said, you know, you're basically putting them all out of business, and these are temporary things. And the truth was, they probably benefitted the country that they didn't liquidate all the insurance companies in the early '30s based on what would have been, in effect, been mark-to-market accounting.

I still -- there's so much mischief when you get away from mark-to-market, that I -- I'm still a believer in it, but I can see where -- I can see certain situations where it might have sort of antisocial effects as well.

Getting back to derivatives, I mean, what has always struck me as extraordinary, is that you basically have four big auditing firms in the country. And I would guarantee you that they are attesting to the statements of firms where they have both sides of a derivatives transaction and there's a different value being put on them by the two parties, and they're signing them under -- I mean, we're talking big numbers

sometimes, too.

It would be interesting to take the million contracts, or whatever – maybe a couple million at JPMorgan -- find two firms that have the same auditor and then compare the valuations.

MR. SEEFER: All right, that would be a good survey for us.

You know, an area we somewhat touched on, that's related to leverage and liquidity are just capital requirements for financial institutions.

Were they too low? Are they too low?

MR. BUFFETT: It's very tough. It's very tough because it's such a difference in how -- what institutions can be doing -- you know, I mean, just take the derivatives book. I mean, how do you measure that compared to straight loans? I mean, are you going to only take the not -- the netted-off, non-collateralized balance, finally? I mean, the residual, and say, "That's the only exposure you have? Are you going to weight some for netting, you know, but only compose at 10 percent?"

It is very tough. And the -- we're going to have higher capital standards, in all likelihood. But knowing what to measure against, it's just a very difficult problem. And, of course, partly that was

solved by people -- people using ratings. And, you know, it -- and the extraordinarily thing, if you look at AIG, my memory is -- and, again, I'm doing all this from memory -- but my memory is that they got up to like a number like 300 billion of what they called "regulatory arbitrage," where it enabled, I think largely German banks, certainly European banks, to carry less capital against their loans, since AIG was guaranteeing those loans against loss, and AIG had an AAA rating; therefore, that carried over into lower capital requirements abroad. And they were getting paid practically nothing for it, and they thought they were running no risk at all. But it was a ratings arbitrage, basically. They called it "regulatory arbitrage," but it was based on what ratings required in the way of capital requirements.

But, you know, the regulators had a terrible job, too. I mean, how do you deal with all these people doing different things and come up with some kind of a standard that says what they have to maintain it with capital?

I don't envy them, their job.

MR. SEEFER: An argument you often hear on the other side from institutions that don't want higher capital requirements is, it's going to impact us

competitively across the globe.

Any views on that response?

MR. BUFFETT: It would. It would. I mean, just take it to the extreme. If you said that every bank in the United States had to have 30 percent capital, and every bank you hear about has a 3 percent capital, you know, doing the same returns on capital, they're going to work on much narrower margins than the American bank.

That doesn't mean you don't do it. But leverage is a competitive tool in terms of achieving returns on equity.

MR. SEEFER: Uh-huh. I guess --

MR. BUFFETT: That's why it has to be guarded against.

MR. SEEFER: Right. Any views on what the right capital levels are for financial institutions?

MR. BUFFETT: It's more complicated than that.

MR. SEEFER: Believe me, I know.

MR. BUFFETT: Yes, okay.

MR. SEEFER: Is imposing some kind of leverage restriction and global the risk, something that, you know, looking back, before banks were able to get into more exotic businesses, you know, 30, 40, 50 years ago, is that something that you think should be a function of

government through regulation or is that, you know, if Greenspan, two years ago, is that something that the market could police itself in some way?

MR. BUFFETT: I don't believe the market polices itself. I mean, that -- Greenspan's a friend of mine; but he's read more of Enren *[phonetic]* than I have, I'll put it that way.

So I did not believe the markets policed themselves in matters of leverage and other matters.

I do believe -- that's why I get back to the incentives of the person. I mean, you really -- that makes a difference.

It doesn't solve everything. I mean, you can still get terribly optimistic managements that will do very stupid things and all that.

But if I had a choice between studying the capital standards and setting the management incentives, and that were my only choice with banks, I would rather set the management incentives.

MR. SEEFER: One of the things we've seen, and that I've seen from my previous life as a bank examiner, but we particularly saw with the broker-dealers was the liquidity issue of their asset liability mismatch; and particularly, if they had a lot of short-term money.

Do you have views on that?

MR. BUFFETT: It’s the nature of financial institutions, both life insurance companies and banks, that no capital requirements protect you against a real run.

I mean, if your liabilities all are payable virtually that day -- I shouldn’t say “virtually all your life,” you can’t run a financial institution and be prepared to that. And that’s why we’ve got the Fed and the FDIC. I mean, they’re -- you can’t stand, if you’re a life company or a bank, you can stand around.

You can be the most soundly capitalized firm in town; but if I hire -- if there were no FDIC and the Fed, and you had a bank capitalized with 10 percent of the capital and I have only 5 percent of the capital, and I hired 50 people to go over and start standing in line in front of your bank, you’re the guy that’s going to fail first.

When they get through with you, they’re going to come over to my bank, too. That’s why we don’t do this sort of thing, because you can’t contain the fire over on the other guy’s bank.

But you can’t -- you can’t stand a run, so you need the Federal Reserve and the FDIC.

And even with Northern Rock, U.K. government came and said, “We guarantee everything.” They still

had lines. I mean, when people are scared, they're scared. And there is no reason to leave -- I mean, if you see -- if it's uninsured and you see a line at another bank -- at a bank where you've got your money, get in line. You know, buy a place from the guy that's first in line, if necessary.

And even if you're in another bank, get in line, take your money and put it under a mattress. You can always put it back a week later. As long as there's no penalties, why in the world -- you know, that's why we got a Fed and a FDIC. And I think it's one of the -- you know, I think the FDIC and Social Security were the two most important things that came out of the '30s. I mean, the system needed an FDIC.

MR. SEEFER: What did -- what did you do? You know, you raising the issue, really, of the shadow banking system that parallels, unregulated without it, FDIC insurance or any other form of insurance other than -- and so they stepped in and guaranteed money market funds as a short-term stability and confidence raiser. What did Berkshire Hathaway do with all of its cash -- I mean, you don't have a mattress big enough.

MR. BUFFETT: That's a very good question, because we were -- for example, in September of 2008, we

faced -- I think it was October 6th or some date like that, we had to come up with 6 and a half billion for our Wrigley deal.

MR. SEEFER: Right?

MR. BUFFETT: I was only going to have that in Treasury bills, even if I had gotten a minus yield, because I had to come up with it. And I didn't know for sure whether, on October 6th, what the situation would be with any bank.

Now, I thought it was 99.99 percent that it would be fine, but I didn't think it was a hundred percent. And I may bring them on to the hearing, I sold a Treasury Bill in December of 2008 for $5,000,090. And it was a $5 million Treasury Bill due in April-something, where I was going to get $5 million. So he was saying that the Treasury Bill was $90 better than his mattress. I mean, he could put the $5 million under his mattress, and been 90 bucks better off in April than he was by buying the treasury.

Well, that's the way I felt, too. I still feel that way, incidentally. I mean, we don't have a whole list of approved short-term investments around here, you know. We've got Treasury bills, basically. And the Treasury is going to print money, if necessary. And that is AAA, I'm willing to go on record on that.

MR. SEEFER: You're giving that rating yourself.

MR. BUFFETT: But nobody else is AAA, in my mind, you know.

And if we're really going to protect ourselves -- if we're not going to -- we need to have real money.

Now, I let the smaller operations, just for matters of convenience, do other things. But in terms of the vast chunk of what we have around here, it's treasuries, and it will stay that way. Because I don't know what could happen tomorrow. I don't know if there's -- you know, pick any kind of a hugely disruptive -- that's what you have to worry about, is the discontinuities. And there will be one someday.

They closed the stock change in 1914, you know, for many months. They closed it for a few days after 9/11. But who knows what happens tomorrow?

MR. BONDI: Speaking of that uncertainty, do you think in the financial crisis, the government created some uncertainty by, for instance, stepping in and orchestrating the deal between JPMorgan and Bear; whereas not stepping in, or at least not stepping in sufficiently, to orchestrate a deal for Lehman?

MR. BUFFETT: Well --

MR. BONDI: Do you think that created an uncertain market for market participants?

MR. BUFFETT: Yes, there's no question that you would have expected, having seen them step in at Bear, you would have expected to see them step in at Lehman. So when they didn't step in at Lehman, the world panicked.

Now, it had all these repercussions, too, in that Lehman commercial paper was held by money market funds, and 30 million Americans held money market funds. And if you get 30 million Americans worried about whether their money market fund is going to be worth a hundred cents on the dollar, they're not going to buy anything. I mean, it -- so, you know, you create a tsunami.

But, you know, the most interesting thing, of course, is if Ken Lewis hadn't have bought Merrill on Sunday, I think the system would have stopped. I mean, he is the guy who turned out to have saved the system. He paid a crazy price, in my view -- well, he could have bought it the next day for nothing because Merrill was going to go when Lehman went. So the government was going to have to step in someplace. And you can argue that they probably should have stepped in at Lehman.

But I will say this: I consider, overall, the

behavior of Paulson and Bernanke and Sheila Bair -- and even though I'm not a Republican, even the President -- I consider that they did a terrific job during that period. I mean, they don't call everything right. And if they made a mistake on Lehman, they corrected it very quick. I mean, they did everything they could to correct it very quickly.

And if they hadn't have done that, and if Ken Lewis hadn't bought the BofA, you know, we would have -- the system would have stopped. Stopped a little bit for a short period, anyway.

But what we saw fall off into the economy subsequently was nothing compared to I think what would have happened otherwise.

MR. BONDI: And following up on that, the commercial paper market, you've alluded to what happened in the commercial paper market there.

Any thoughts in terms of additional safeguards or anything that could remedy what had happened in --

MR. BUFFETT: Pretty tough. We don't buy commercial paper. But I do believe, if you ran into a similar situation to that, they've got more guarantee commercial paper, then they'd have to.

That's the important part. You have to believe the government -- federal government -- will

act, and they will act promptly, decisively, and all of that sort of thing. That became, I guess, a little bit of -- more than a little bit of question, a significant question after Lehman.

The Treasury and the Fed remedied that very quickly by taking -- in my view, by taking action.

I said it was economic Pearl Harbor, but we sent out -- you know, we sent out the fleet the next day. But we had the ships in the harbor, unfortunately, on the day Lehman failed.

But you saw when the first TARP-type arrangement got defeated in Congress, and what happened in the market. Congress was the big fear with, I think -- was the biggest fear with the American public at that time.

MR. BONDI: How do you draw the line for determining whether the government should intervene for a specific institution and not -- or would you --

MR. BUFFETT: Well, I think you did it right in Bear. They wiped out their stockholders pretty much. I mean, you lost 180, down to 10, as it turned out. But if Paulson had his way, it would have been $2 or less.

So he wiped out the shareholders.

Now, again, you know, the management, Jimmy Cayne lost a lot of money; but he's a rich man. And so

that -- and that did not set a good lesson for the rest of the world, in my idea. But you set a big lesson in terms of the shareholders.

And I think if the government has to decide -- if troubles are brewing, the government should err on the side of overkill.

MR. BONDI: How would you decide, though, between stepping in on Bear and not stepping in on Acme or another financial institution? How do you draw the line, in your mind, what's --

MR. BUFFETT: Well, with banks -- with banks, it's easy, because the FDIC can handle everything except Citigroup and BofA. I mean, they handle Wachovia, in their own way; they had WaMu. I mean, we had 8 percent or 9 percent of the repository in the United States change hands without the federal government getting involved even. But the FDIC could not -- they participated in the situation with Citi. But Citi would have been probably too much – well, Wachovia was the third largest in the country, and they got it done.

So I -- stepping in -- you don't need to worry about stepping in on institutions around here. But you had to step in on Freddie and Fannie. There wasn't any question about that. And then you get -- they really didn't need to step in -- if they did with Morgan

Stanley or Goldman Sachs or Wells Fargo, but they did need to get the system -- they needed to give the American public the confidence they would do whatever it took.

Now, those firms didn't need it as long as the system didn't totally collapse. But as part of convincing the world that the system wasn't going to totally collapse, they were part of the movie that took place.

MR. SEEFER: We're very close to being done because we started a little bit early. So I thank you.

A couple of questions.

Do you have any sense as to what the difference between what's going on in Europe is, and what went on in Europe is, and what happened here? Because clearly, Europe didn't have the same kind of crazy housing bubble that we did.

MR. BUFFETT: It's very different. It's an even more interesting movie.

And since this is on tape, somebody will find out how it all plays out, but I don't know how it will play out.

It's a different situation, in that -- in the United States, we were saving ourselves. And we wanted to be saved, and we wanted Washington -- we knew only

the government could save us, basically, at the time from a colossal collapse. And even with that, a year and a half later, a lot of people are mad at the people that participated in doing, when all we were trying to do is save ourselves. We weren't trying to save Mexico. It wasn't like we had a North American union, where we all were tied to the same currency, and Mexico's problems were *[unintelligible]*.

Can you imagine what the reaction, if we had been saving Mexico instead of the United States, to the legislators and the regulators that were involved?

So Europe would have to act big, but they have a system where a group of people are going to have to be helping another group.

Now, we all think we're Americans; so when America is saving America, that can be pretty cohesive. But although, like I say, it still is recriminations, all kinds of things have come out of it.

Now, you picture Europe, where you've got a group of people that are being asked, perhaps, to put a lot of money in, perhaps bear a lot of burdens, perhaps incur inflation, to help another group who they don't think have been behaving in the way they would have behaved. And they don't really have the, you know, ethnic social connection. I think it's -- it's really

problematic what happened.

MR. SEEFER: So do you think there are any parallels in how their problem developed? Or is it really a European problem as opposed to a housing bubble --

MR. BUFFETT: The problem develops because, in the end -- for a long time, everybody thought they were all equal. And if you had a Euro-denominated bond, it didn't make any difference, or you had a deposit from any one of 16 countries, it was the same thing. And all of a sudden the market started receding, and that wasn't the case.

And once people started thinking about it, they realized it really wasn't the case, and this thing's only been around for, you know, less than 15 years, or whatever it is. And they started thinking, "Maybe I'd better line up at that bank." And they don't have to do it physically. They start pushing little buttons, and money starts moving around, and all of a sudden 16 countries have a problem. They think -- most of them think they weren't part of it. And that is -- could be enormously contagious.

No one has to buy a Greek bond. Nobody has to buy a Spanish bond.

Now, usually when -- in America, the Central

Bank has to buy it. It may be a roundabout process. But we know somebody will buy U.S. bonds tomorrow because we've got a central bank that's totally in sync with the interests of the country and will print money, if necessary. And nobody -- Greece doesn't. Greece doesn't have the power to print -- you know, it would be fine if their obligation were drachmas.

So it's a very, very interesting problem. And I won't predict how it will come out, because you've got a tape and I would look very dumb later on.

MR. COHEN: So do you have any books that you liked, that have been written on the crisis?

I know that, Sorkin has worked with --

MR. BUFFETT: Sorkin has written a very good book.

I mean, there have been a number of good books.

MR. COHEN: Yes.

MR. BUFFETT: The book I would write if I was in the writing business, I would right a fictional book.

And my book would probably be titled something like, "If Ken Lewis hadn't answered the phone," and then I would go from there, forward, with Merrill falling on Monday, and describing what the world would have looked like.

It would be a hell of a book. I'm not sure what the ending would be.

But, you know, I mean, he got that call on Saturday, he gets a fairness opinion in 24 hours from two guys that are getting $10 million each as the fairness of buying Merrill Lynch at $29 a share, which is -- I mean, that is --

MR. COHEN: Chris Flowers.

MR. BUFFETT: Yeah, Chris Flowers, and another firm that is affiliated with Chris Flowers.

And do you think Chris Flowers would have paid $29, or $2.90 for Merrill Lynch on Sunday?

It's an interesting world. But it may have -- it may have saved the system some terrible acts -- it may have actually saved the system.

MR. COHEN: Okay.

MR. BUFFETT: If you decide to write that book, I don't expect any royalties.

MR. COHEN: At the rate we're going, it will take a long time.

MR. BUFFETT: Yes, I know.

MR. COHEN: Well, thank you -- thank you very much.

MR. BUFFETT: Okay.

MR. COHEN: Thank you also for agreeing --

agreeing to be subpoenaed.

MR. BUFFETT: Oh, I thought what you suggested was kind of interesting about the police car. Because imagine being subpoenaed for a hearing, and then leaving with a publishing and going to Sing Sing, which I'm doing now.

MR. COHEN: So we'll get you out of there by two o'clock, so you can get up to *[unintelligible] to* see your sister and then go to Sing Sing and the graduation. I actually looked it up and read about it, so it's very nice.

MR. BUFFETT: Yes, you ought to read the book about my sister. It's a good book. It tells about the whole Sing Sing situation.

MR. SEEFER: Okay.

MR. BONDI: Mr. Buffett, it's 11:50 a.m., and we're going off record.

Mr. Buffett: Okay.

(End of interview with Warren Buffett)

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