

MEMORANDUM FOR THE RECORD

Event: Interview of Lloyd Blankfein, CEO Goldman Sachs

Type of Event: Group interview

Date of Event: June 16, 2010

Team Leader: Chris Seefer

Location: Goldman Sachs Global Headquarters, 200 West St, New York, NY 10282

Participants - Non-Commission: Lloyd Blankfein, Greg Palm, Janet Broeckel, Richard Klapper (Sullivan & Cromwell), Ted Edelman (Sullivan & Cromwell)

Participants - Commission: Chris Seefer, Tom Greene, Bob Hinkley, Tom Stanton, Carl McCarden, Clara Morain

MFR Prepared by: Clara Morain

Date of MFR: June 20, 2010

Summary of the Interview or Submission:

This MFR is a paraphrasing of the dialogue and should not be quoted as a transcript. A transcript of this interview was also prepared and can be viewed by clicking on the following link:

<https://vault.netvoyage.com/neWeb2/gold.aspx?id=4815-2501-5046&open=Y>.

Investment Banking versus trading operation

Mr. Blankfein did not agree with the conclusion that Goldman Sachs transformed itself from a traditional investment bank into a trading operation, although he agreed that over time, sales and trading has generated an increasing share of Goldman's revenue. "We are an investment bank," he said, "and as we sit here today, and for each year that we've been a public company, we're the number one firm in [mergers and acquisitions] on every survey, with the exception of 09," when one survey had Goldman Sachs tied for first in mergers and acquisitions. Blankfein said that Goldman's investment banking is the front end of the business, an important source of revenue and an important source of business the firm would not otherwise receive. Blankfein said that the increased significance of Goldman's trading operations is a function of changes in the market, not of any strategic decision within the firm. "Corporate business has been soft for the last several years, whereas the sales and trading opportunity hasn't been, and so part of it is just that the sales and trading business has gotten bigger, and part of it is the investment banking business has been in a bit of a recession because that's driven by the amount of m&a business that's done, and that has been very well correlated with GDP and growth," he said.

Leverage

Blankfein said that there was "certainly no decision to be more leveraged" at Goldman Sachs. He said that until recently when the external market began caring more about leverage, Goldman did not look at leverage as a meaningful metric for understanding the financial condition of the company. "Until recently, I wasn't even conscious of what our leverage was, in the sense of, the amount of our gross assets versus our equity. I always thought of it [] was in terms of risk of the way our balance sheet was run... We had no decision to be more leverage or more risky," he said.

Derivatives

Mr. Blankfein stated that “it’s a little bit artificial for me to think about derivatives.” Rather than thinking about derivatives as a distinct business or an asset class, he said that he views them as instruments for generating exposure for a client, for hedging risk, or for taking a position. “Most of the time, I don’t think about being in a derivatives business, I think of [for example] being in a commodities business and a commodities business has to take positions, or give clients what they want, or hedge the risk... you’re going to have access to futures, cash instruments and derivatives and also, if you’re in the business long enough, physical in that particular thing. And I don’t think of [derivatives] as separate, and the people who trade [derivatives] are usually somebody oriented toward an asset class,” rather than to derivatives more broadly.

Blankfein said that he does not think of “derivatives risk” as a meaningful risk management concept. “To me, derivative risk as a concept just means the risk the derivative doesn’t work... I don’t think of equity derivatives, I think of equity risk. I’d never say ‘what’s our risk to equity derivatives?’ I’d say, ‘what’s our risk to the S&P?’” he said. “When I’m looking at risk I’m not thinking about what form it’s taking, I’m thinking about the exposure,” he said.

When asked how Goldman managed counterparty risk, Blankfein said that Goldman relied on exposure limits, netting agreements, and various “processes and technologies” to manage counterparty risk. He said that to the best of his knowledge, there would not be a way for Goldman to have information about the total amount of CDS AIG wrote to counterparties other than Goldman. “You’d rather have more information about counterparties than less. You have more interest in and you have more leverage in getting it the weaker the credit of the counterparty is,” he said.

Blankfein disputed the notion that synthetic CDOs are a socially-valueless form of gambling. “Yes, it’s a bet,” Blankfein said. “But it has social utility because it’s adding liquidity to the market and the market isn’t useless – it’s mortgages.” He said that like any derivative, mortgage derivatives allow investors to craft the specific exposures they want to have in their portfolio. The ability to sculpt a portfolio of mortgage products using derivatives lower transaction costs without changing the underlying portfolio, he said. Blankfein compared synthetic CDOs to trading in corn futures or government bonds – markets that are also “many, many multiples of the actual number of government bonds or corn or whatever.” He said that “on the other side of this crisis, we’re going to want a mortgage market,” and synthetic CDOs are going to be part of it.

Goldman’s relationship with AIG

Blankfein said that he became aware of the collateral call disputes with AIG sometime in the fall of 2007 when the discrepancy between the margin demanded and the amount posted continued to grow. “I was posted that the conversations were hard, that [AIG] owed us money and weren’t paying, it and were being very stubborn about the valuation issue,” he said. Blankfein noted that at the time, AIG was still considered “one of the great credits in the world,” and so he was not looking at the margin calls themselves, and he was not worried about the credit. “I was posted that it was becoming a very, very stressful thing back and forth” between Goldman and AIG, and so he spoke with AIG CEO Sullivan to encourage a resolution of the “non-commercial behavior” that was taking place surrounding the calls. Blankfein said that he recalls Sullivan expressing “deference” to Cassano and AIGFP on the call, and conveying the view that AIG was confident in its marks. Blankfein said that he recalled that shortly after speaking with CEO Sullivan, AIG did post some of the collateral it owed Goldman.

Blankfein said that he assumed that the marks Goldman used with AIG were the same marks it used with its other trading parties. “To the best of my knowledge, that would be the way we would do that. I don’t know anywhere we’d do it otherwise,” he said.

Blankfein said that Goldman purchased CDS against AIG while collateral disputes were ongoing, because when the company had a risk that was not being covered by a margin, the company's risk management protocols dictated that it needed to either buy protection or remove the risk. Blankfein said that "at the time, I remember thinking – ironically – thinking what a waste of money this is going to be," because he had no doubt that ultimately, AIG was going to pay the margin, but Goldman would still bear the cost of buying protection to cover its exposure during the period where AIG was behind in delivering on the collateral. Because Goldman did pay to cover its credit risk with AIG, Blankfein said that its exposure to AIG was "minimal," which explains why the Goldman "would have been fine" in the absence of the Maiden Lane transactions.

When asked by FCIC staff if he ever became concerned about AIG's ability to survive, Mr. Blankfein said, "I hate to tell you this, but I never really did, not until everyone else in the world started thinking it."

Risk Management

Blankfein emphasized that Goldman's daily mark to market policy is the cornerstone of its risk management. "If you don't mark to market, I don't know how you could perform risk management. If you're carrying something at a historical price in a world that's changed, I just don't understand how you could manage risk effectively," he said. Blankfein said that "I don't think it takes more time to do it right, it's more about importing the discipline into the culture." Blankfein said that everything in Goldman's book should be "marked roughly to where we can get rid of it."

Blankfein said that Goldman's compensation practices are aligned with the risk management priorities at the company, noting that the controller staff receive compensation comparable to traders' compensation, which is one of several measures the company employs to ensure that risk management functions are held in equal prestige with other departments in the company. "The risk management business has nothing to do with what you think. I always say that 'this is a risk management exercise not a what do you think exercise,'" he said.

Blankfein stated that "the real issue [with AIG] was risk management. They did not regulate their risk... you could bar derivatives from the planet and it wouldn't get at AIG's [problems]," he said.

Timberwolf and related transactions

Blankfein disputed the notion that Goldman sold investments to clients who did not understand the risks involved. "Of course we want to disclose everything," he said. He said that he did not know the Timberwolf transaction specifically, but he dismissed the notion that the client involved would have believed in late 2007 that the market was stable, particularly when the client invested in the CDO below par. "We only sold this stuff to people who were expert in this area," he said, and indicated that deals done towards the end of the bubble that lost money did not lose money because of a flaw in the CDO itself. "A vehicle that loses money is not necessarily a defective product – it's not a car with faulty brakes, it can be a perfectly great car driven in the wrong direction," he said. Blankfein compared it to making markets in Spanish debt and BP debt right now, which Goldman is doing, he said. If investors on the long side of those deals lose money, it will not necessarily be because of a flaw in the investment vehicle.