

MEMORANDUM FOR THE RECORD

Event: William Cohan, author of *House of Cards* and *The Last Tycoon*

Type of Event: Interview

Date of Event: July 30, 2010 (11-11:45 am)

Team Leader: Matthew Cooper

Location: FCIC, Phone Interview. FCIC participants used the large conference room.

Participants – Non-Commission: William Cohan

Participants – Commission: Matthew Cooper, Gary Cohen, and Adam Paul

MFR Prepared By: Adam Paul, Matthew Cooper

Date of MFR: July 30, 2010

Resources mentioned:

William Cohan, [Contributions to](#) the New York Times Opinionator Blog including

“[Mystery Men of the Financial Crisis](#)”, By William Cohan, The New York Times, February 4, 2010

Summary of the Interview:

This is a summary of the interview dialogue and is not a transcript and should not be quoted except where clearly indicated as such.

The major cause of the crisis for Cohan is the change in compensation that has occurred since the 1970s. Cohan has seen multiple crises in his professional lifetime. While this crisis has been much more severe it follows in a string of 4-5 previous events that Cohan mentioned.

Cohan, who wrote extensively about the 2005 decision by Lazard to go public, said that ending partnerships deeply impacted finance. Lazard, which employs many fewer people than its competitors (about 2,500¹ compared to about 22,000 at Goldman Sachs²), still follows a model that depends less upon traders. “If more firms were like Lazard, the crisis never would have happened.”

¹ http://www.vault.com/wps/portal/usa/companies/company-profile?companyId=898&WCM_GLOBAL_CONTEXT=/wps/wcm/connect/Vault_Content_Library/companies+site/companies/parent_lazard/lazard_0/lazard_0

² <http://money.cnn.com/magazines/fortune/global500/2006/snapshots/575.html>

When Cooper asked about the causes of the crisis, Cohan responded: “This comes from an intimate 17-year knowledge of Wall Street and it gets back to the incentives that exist on wall street and the behavior of people who work there....It’s very simple in my mind: Human beings do what they get rewarded to do.”

Cohan cites a fundamental change in the way that Wall Street has organized itself from “small undercapitalized partnerships where capital came from individual partners’ pockets that they were required to invest in the company to become a partner.”

“Because of the way the partnerships were organized,” Cohan told the FCIC, “it made them have their net worth on the line and it was a precarious situation...but they were also highly attuned to the business that was being done.” He noted that the flood of partnerships going public began with Donaldson Lufkin and Jenrette in 1970 and now all the major investment banks are publicly traded corporations. “The behavior changed,” Cohan said because risk was no longer on the individual but on the corporate. “This whole battleship was motivated by one thing, getting the biggest bonus year in and year out...If you were a MBS salesman all that mattered was selling more, generating that fee income...”

Cohan acknowledges that this led to financial innovation. But the consequence of the innovation is that those on Wall Street were only motivated by selling the new products. Cohan notes that the pay structure is extraordinary with people doing unexceptional things getting huge bonuses. “We’re biding our time until another crisis,” he said because the basic pay structure has remained the same and will be unchanged by the new financial reform law. The current structure, he said, encourages reckless risk taking because the firms are using other people’s money and do not have their own skin in the game. “

Part of what bothers Cohan about Wall Street compensation is how “unexceptional” the work is. Cohan, who worked in finance for many years, says that the bulk of staff at big firms “are intelligent but not stand outs.”

“By and large, there is no other place where good soldiers can go and make the money they can make on Wall Street. It’s not like paying [baseball’s] Alex Rodriguez to perform or [basketball’s] LeBron James. These people have unique talent. But on Wall Street people are more good soldiers and there are very few people have extraordinary talent....The people with real talent own their own investment firms... by and large there’s no other place on the face of the earth where people who are good soldiers and who are smart but not extraordinary can go and make the kind of money that they can make on Wall Street. I was living proof of that....I was not an extraordinary M & A guy and I was paid more than I had any right to be paid.”

Cohan quoted Sen. Chris Dodd (D-Connecticut) approvingly saying “we’ve privatized profit and socialized risk.” Cohan said facetiously that he believes that there should be a new class of security that represents the net worth of the top 100 people and people overseeing the risks being taken: “So the first thing that disappears is their net worth.” He notes that Jimmy Cayne, the

former Bear Stearns CEO, had already socked away \$400 million and the rest is “the house’s money.” He notes approvingly that what Goldman does is the Partner MD (managing director) concept where the top 300-400 people get paid out of the pretax income not revenue. “It’s not liability but if there was a loss they would not get paid,” said Cohan “Which is why they are a devoted mark-to-market firm.” He said he thought this was a modest improvement over the compensation system at most firms.

Cohan suggested the FCIC call in witnesses who have seen the system change over the years such as “William Donaldson [former SEC Commissioner and formerly of Donaldson, Lufkin & Jenrette] or Felix Rohatyn [the former ambassador to France and Lazard Freres partner].”

Cooper asked about Lazard Freres—which Cohan has written about in *The Last Tycoons*--going public and whether he had seen in its culture when it went from partnership to publicly traded. Cooper said that they had been late to go public but asked if Cohan had seen a change in their risk taking. Cohan noted that “They went public in 2005...But if more firms were like Lazard, this crisis wouldn’t have happened. He noted that in the early 1970s Morgan Stanley, Lazard Freres, and Goldman Sachs were all about the same size but that while Lazard stuck to providing M & A and spun off its capital markets business the others just got bigger and bigger.”

Cohan said that there’s always tension between traders and bankers and he thought bankers would be ascendant after the crisis or a third type, a corporate manager. He lumped John Mack of Morgan and Brian Moynihan of Bank of American into this category. He thought because traders were less powerful now, Gary Cohn, would not replace Lloyd Blankfein at Goldman.

On the question of Bear Stearns, about which he wrote *House of Cards*, Cohan said “I think they should have just let Bear fail ...If you’re [Lehman Bros. CEO] Dick Fuld you would have immediately started doing what you needed to do.”

Cohan said the move to save Bear “was well meaning but the market is a very powerful force and that message was warped and by the actions of the government at that time ...Had they let Bear fail, Lehman would have taken the steps to save itself.”

Perhaps not surprisingly, Cohan added that “having Lehman fail was exactly what needed to happen.” Cohan said that the Valukas report on Lehman’s bankruptcy showed it had engaged in “screwed up” accounting and was being “duplicitous.” Cohan declared: “I think the best thing was the market rendered the harsh judgment.”

Gary Cohen asked what else the commission should investigate in its last months. “I think you’ve done a remarkably good job investigating the acute causes of the crisis,” Cohan said, referring to the collateral calls against AIG, the short term nature of financing on Wall Street, borrowing short and lending long. Cohan returned to his earlier point and said “I haven’t seen much on the pay structure on what they’ve done in the past and what they do now. He urged the FCIC to do some “drilling down” on this issue. Cohan continued with his point about the pay

structure: “This thing is a very hard thing to change. And if I was the Wall Street czar for a day I would change it immediately. If you think about it, the revenue of these firms is property of the shareholders—that revenue belongs to the shareholders....but when you have this crazy system and is paid out in the form of compensation to the benefits of the people who work there. This revenue belongs to the shareholders but doesn’t really get to them. Why should we be rewarding people on Wall Street? Shouldn’t we be rewarding people who heal the sick and the people who educate our children and investigate these crises instead of the people who perpetrate these crises...a session that focused on that would really get to the heart of the matter.” There was a brief discussion of compensation experts including Lucian Bebchuck.

Cohan expressed concerns that the most recent financial reform legislation does not address the compensation structure. He also noted work by Treasury Department special master for compensation Kenneth Feinberg provided a major incentive for firms to quickly repay their TARP funds. “We are bidding our time until we get a crisis of a different nature with similar incentives,” said Cohan. Cohan noted that they got out of TARP quickly so the special master would not mess with their compensations structure.

Had Bear failed, Cohan believes that Lehman Brothers and Merrill Lynch would have acted more quickly to solve their positions. When asked by Cooper if JP Morgan would have bought Bear without the government assistance, Cohan gave reasons that JPM did not really want Bear too badly but declined to speculate.

Cooper asked Cohan what information he would try to learn if he had the Commission’s subpoena power. Cohan responded that he would like to know more about the firms or individuals who bought short-dated puts on Bear Stearns in the week before it failed. He indicated that Kyle Bass, John Paulson, and Goldman Sachs would be good candidates to consider. Cohan agreed to speak further with the FCIC if necessary.