**MEMORANDUM FOR THE RECORD**

Event: Interview with *House of Cards* author William Cohan

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Team Leader: Tom Krebs

Location: FCIC large conference room

FCIC participants:

* Wendy Edelberg
* Tom Krebs
* Tucker Warren
* Karen Dubas

Non-FCIC participants:

* William Cohen, author

MFR prepared by: Karen Dubas

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Summary of the Interview or Submission:

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

**KREBS:** Why do you think they lost the BSAM case?

**COHAN:** First of all, the judge, if you look through the records, there was a lot of information that he wouldn’t allow: the Gmail, the whole thing with Florida. That blew my mind.

One of the things that came up later in the trial and the discovery was that Cioffi had pledged his interest in the hedge funds as security for a loan for a real estate development in Florida. He was told that he couldn’t do that by the Bear Stearns general counsel’s office, but he did it anyway. That was a few years before. He was going to default on the loan because of the loss of value in the hedge funds. This started to come out right before the trial started, and the judge wouldn’t let it in. Right before the trial, he flew to Florida to try to intimidate the bank person who had the records, and she said that she had already turned them over to prosecutors. I don’t know if it was criminality, but it didn’t look very good.

The SEC seems to be culling strategically from emails and using the portions that are the most damaging, but the whole email will be entered into evidence and the jury will get to see it. That’s what I’m worried about in the SEC Goldman case.

There were a lot of problems with BSAM—putting out that they only had 6% in subprime when they really had 60%. There was also a smoking gun email with a talking points memo about what for brokers to say about the hedge funds.

**KREBS:** Do you have that document?

**COHAN:** I’m pretty sure I do.

**KREBS:** I’d like to see it.

**COHAN:** I’ll have to look for it.

**KREBS:** It shows that they were trying to cover up a good portion of what was happening at the hedge funds.

**COHAN:** There’s no question in my mind that there was a good case to be made.

**KREBS:** How much competition was there between the Southern and Eastern districts?

**COHAN:** I’m not sure. Right after the verdict I had a piece in the *New York Times* about that and what they did wrong. That was embarrassing. It was clearly a botched prosecution.

They would come out and say things like, “We would have been happy to give our money for Cioffi to invest.” For a juror to say that…

There are several important linkages. Goldman’s decision in December 2006 to begin to short the mortgage market is the crucial moment in all of this. They alone of all the firms decided to do this. They’re now being excoriated, but in my mind they should be congratulated or else they would have been another victim.

As their respected research analyst said, this hiccup in the housing market is a buying opportunity. People are excoriating Goldman Sachs just because it worked out. When they made their decision, they took their marks down and they had to report their marks to the rest of the market. It hurt the market, but the question is: Were they also shorting Bear?

People were betting millions of dollars on the outcome of Bear Stearns going down, which would have been preposterous, except that it happened. The same thing happened with AIG. The question is: Did Goldman do it knowingly, or did they just exacerbate what was going to happen anyway?

**KREBS:** Bear Stearns invested a lot of money in a research group that clearly got it wrong.

**EDELBERG:** If you had some of these guys in front of you—the regulators, Bear Stearns—what would you ask? What would the public need to know?

**COHAN:** What the public needs to understand is what the effect that Goldman’s December 2006 decision had on the broader market of securities.

**EDELBERG:** Does it have to be nefarious?

**COHAN:** No. But there’s also a talk of interconnectedness. The way that Goldman’s marks affected AIG and Bear Stearns is a prime example of this. When Bob Steele made that decision back in March to save Bear Stearns, they made that decision because of interconnectedness. What are examples of that? The Goldman marks are a concrete example. It wiped out BSAM, which wouldn’t have been as much of a problem if Bear Stearns hadn’t become the repo lender and bought all of those mortgages. The question is whether that happened with Lehman and Merrill as well.

Goldman’s marks were so far below everyone else’s that (1) they believed it, and (2) they weren’t as long as everyone else.

**EDELBERG:** What do we ask Bear Stearns about being interconnected?

**COHAN:** If you had Rich Marin in front of you, ask him to explain what effect those marks had on him. I’d want to know from the SEC, who is supposedly investigating the shorting and buying of the puts, where is that? Where is that investigation?

**EDELBERG:** How do you see Bear Stearns and the financial crisis?

**COHAN:** It’s the canary in the coal mine. What happened to Bear Stearns was happening everywhere else. March 2008 was the volcano exploding. But February to March 2007 was the magma boiling. I think that when Bear saw its hedge funds imploding, it knew that it was dead.

**KREBS:** When Bear Stearns tried to get into secured lending through repo….

**COHAN:** They weren’t doing that voluntarily. The market wouldn’t give them unsecured lending.

**EDELBERG:** Is there anything that Bear Stearns could have done?

**COHAN:** They could have raised money—they could have sold themselves. They needed equity. They were so highly leveraged—50:1 intra quarter, 30:1 at the end of the quarter. Jimmy Cayne could have diversified the firm. He could have done some of the stuff that Lehman did.

When I talked to Schwartz a year later, he still said the same things. “What could I have done?”

**EDELBERG:** Back to 2005 or 2006, was Bear taking a big risk and going all in?

**COHAN:** Yes, they went all in. That’s allowed. But they went all in with none of their systems working. They didn’t have a risk management function. Jimmy Cayne had no idea what was happening. They would have made better decisions if all systems were running and if they didn’t have a CEO who was a bully.

It’s not an accident that Goldman made this decision. Blankfein had been a trader, he understood the risk. They had a very polished risk management function. They had 300 real partners, and they looked at risk management much more diligently. They had been in touch with John Paulson, and they started thinking about what he was doing. Their traders were seeing defaults rising. There were fits and starts with the decision throughout 2007. People say that it’s this tsunami and make it seem like they were victims, but there were affirmative decisions over a number of years that lead to this.

I think Geithner, Bernanke, and Paulson understood how bad it could be when they bailed out Bear Stearns in March.

**EDELBERG:** One can assume that if a firm goes bad and you need extraordinary government intervention, then it was a surprising event. Wouldn’t a regulator have said that something bad is happening? Did the SEC, Fed, and Treasury not understand what was going on?

**COHAN:** In June 2004, the SEC changed the rules about leverage and were going to more closely monitor it. I think they forgot to do that. Geithner understood that things were getting bad. He even had Mike Alix co-chair one of them, but he said that he was not the regulator of Wall Street.

You had Volcker making a speech at Stanford in February 2005. He basically said that my blood is boiling and my instincts are telling me that trouble is coming. There’s a Merrill Lynch research report in 2004 that trouble is coming in the market. At the end of 2005, Meredith Whitney was writing a couple of reports here and there. Paulson and Kyle Bass were starting to make their beds.

But from people who continued to write mortgage-backed securities, they’ll say that they didn’t see it until you started to see the delinquencies start to tick up. They began to see that in the summer of 2006. I think that began to really hit home with some—or maybe just Goldman. Six months after Goldman began to get the religion, Merrill bought First Franklin and increased their CDO exposure.

**EDELBERG:** Was the SEC doing its job?

**COHAN:** They would have seen that the leverage was way out of control. They weren’t monitoring how it was happening. They would have seen what assets were going on the balance sheet that were causing the leverage to go up. They were mostly mortgage-backed securities that got squirrelier and squirrelier.

**EDELBERG:** Is it as simple as Bear Stearns was not being transparent about how risky their mortgage-backed securities were? If the SEC had been on the ground, would they have seen how risky these assets were?

**COHAN:** Yes, but part of this is 20/20 hindsight, because I’m sure Bear Stearns thought that these were safe assets. There’s a lot to be said for that. Not many people understood.

**KREBS:** These guys have been in the trenches doing valuations on the broker-dealers using net capital for years.

**COHAN:** The broker-dealer holding company distinction. I’m sure they can explain themselves. As far as I can tell, they didn’t make an appearance at Bear Stearns until August 2007.

Ironically, I think that when the Bear Stearns stock hit its all-time high in January 2007, it was already too late. It wasn’t just Bear—it was the business model. I think they became completely infatuated with the profits that they could make. They did the same thing with junk bonds and IPOs. It’s the same thing ever since they became public companies and their incentives get skewed.

**KREBS:** What could Schwartz have done?

**COHAN:** I think it was too late for them by then. I think that hope was the strategy. He tried a number of things in those three months.

The Citic deal was Jimmy’s folly. One of Jimmy’s friends was close friends with the Citic folks. His incentive was not to raise equity—with his compensation, he wanted that equity to remain low. It wasn’t just Jimmy on the Executive Committee. Ace Greenberg, Warren Spector, Alan Schwartz—none of them did anything, they paid lip service. Jimmy ruled the place as a dictatorship.

It’s very typical on Wall Street, with the exception of Goldman. Anybody with a different idea was not really welcomed. This is a cultural problem, and when you marry that autocratic management style with an incentive system that encourages you to take huge risks with other people’s money, that’s what happens.

**KREBS:** Of Bear’s management, who is most likely to rat them out?

**COHAN:** Upton is good. Maybe Molinaro.

**WARREN:** What would you ask Cayne?

**COHAN:** I was interviewing him from May to December 2008. Between May and December he would say things like, “Everybody’s picking on me, but I’m not the only one here. All of these guys are going to go down.” He was never happier than after that September weekend. All of my conversations with him were on the record, taped, and transcribed.

Obviously the guy who knows everything is Warren Spector. He knew everything. He’s nervous because he walked off with $400 million. He was the brains behind the entire operation. He’s a very smart guy.

**KREBS:** Why didn’t he see the early warning signs?

**COHAN:** Different incentives.

**KREBS:** Was he insulated from those type of reports?

**COHAN:** I don’t know that anyone would have been looking at that kind of thing at Bear. People just wanted to be a mortgage making machine. When the supply got low, they bought a mortgage originator. They never thought of themselves as having to hold any of the assets. They were just making and selling. Their warehouse lines were just where they loaded up their assets.

**KREBS:** I expected that Upton would let me have all of the information about whys and hows. He said that after Lehman and Merrill, he says that it became a tsunami.

**COHAN:** He was the CFO of Ameriprise. That could turn everything around. He was very angry when I talked to him. He’s lawyered up now. In a story with few heroes, he was one of them. He was heroic in what he tried to do, and they wouldn’t listen to him.

**KREBS:** It was so at odds with what I’ve read that the first thing I wanted to do was to get in touch with you.

**COHAN:** He told me, and I wrote about the things that he tried to do.

Paul Friedman is in a very tough position. Now he works for Schwartz, but again, all of my interviews were on the record and were all transcribed.

**WARREN:** What would you ask Cayne now?

**COHAN:** I would probe more deeply into whether he understood the risks. He said he didn’t—he could either be stupid or criminal, and I think he went for stupid. He’s stupid like a fox. He understood the risks that were in the other firms and he understood all sorts of things. But he said that he wasn’t smart enough to understand the risks. But the question is, what would he have done differently. Would he not have fired Warren, would he have retired earlier, would he have gotten a better risk apparatus? They got into trouble because of their compensation system, their failure to diversify. Should he have sold the firm when he got the chance?

What about the structure of the industry and the fact that they were so dependent on short-term financing? Why did they do that? At the end, they had no choice, but they were paid on a return-on-equity position, and they wanted to short-term finance. Goldman did do it differently. Bear wanted you to believe that there’s no other option, but there is.

There was a time when Lazard, Morgan Stanley, and Lehman were all of the same size. Goldman is less reliant on short-term financing, but they pay higher interest expense—they could be a lot more profitable if they were doing it.

For awhile, those five guys on the Executive Committee got paid more than any other guys on the Street. Jimmy is engaging, witty, funny, and tells stories. He’s charming. That’s why he’s so great to have as a character in the book. But he had a vicious temper and ruled as much by fear as by anything else.

**WARREN:** You were talking about the mindset—with Cayne ruling with an iron fist. Are all other firms the same except for Goldman?

**COHAN:** At every other firm, by the time you claw your way to the top, it’s a pretty great job. You don’t want to give it up. Cayne, Fuld, John Mack—even at Lazard. To get a change at Morgan Stanley, you have to have a coup. At Goldman, it’s a different mentality. You get 5-8 years at the top at best, and then you have to make room for someone else. That’s very empowering for the younger generation. There’s a rotation that people get.

The other thing Goldman does best is communicate. At Bear Stearns, you have Upton trying to get his message through, and no one would listen to him. At Goldman, all of the information is bubbling up from below. Mostly because they thought they could make a lot of money—it wasn’t about doing the right thing. It turned on a dime once that information got up there. Schwartz’s comment that it was like turning around a battleship or firing a lot of people is a crock. He could have done what Goldman did.

Jimmy alienated Warren Spector: calling him out publicly for his politics, embarrassing him at bridge tournaments, alienating the guy who runs 90% of the business. Jimmy alienated him so thoroughly that all Spector wanted to do was screw him. A focused and engaged Warren Spector would have seen the risks and would have done something about it.

Schwartz clearly didn’t understand the mortgage market. Alan wanted to buy Neuberger and Berman, and Jimmy shot all of his ideas down, so Alan eventually sat back and decided not to rock the boat.

**WARREN:** If you had Cayne, Spector, and Schwartz, and you wanted to pursue a line of questioning that would make it difficult for all three of them to be on the same page, what would it be?

**COHAN:** Questions about why the firm failed to diversify, either in investment banking, in Europe, or in asset management. Why Warren allowed Cioffi to do these hedge funds? Why they didn’t get real hedge fund managers? If you could get Warren talking, there’s no question in my mind that if he were engaged he would have seen the risks. He was one of the best Fixed Income guys on the Street. He was the mastermind of the business. Why didn’t Jimmy listen to him? Why did Jimmy let his petty jealousies and weird Oedipal relationships allow him to act like this?

There are a lot of good questions to be asked. It would be nice if someone would come forward and say what really happened. The reliance on overnight financing and the focus on generating revenue and getting away from having skin in the game.

**KREBS:** The only way that they could raise money was buy going into the repo markets.

**COHAN:** There’s no way you would ever advise a banking client to finance yourself the way that these guys financed themselves. You gave all of these creditors a vote every night about whether to do business with you. Who else gets a vote every night? The moment you get a whiff of death, you’re gone.

**KREBS:** The New York Fed said that they saw the novations coming. I’m not sure I understand the back office glitch with respect to the novations.

**COHAN:** I think in this particular case with Bass, he had a trade with Bear Stearns and they were counterparties. I think the trade had 3 more years to run, or something, but Bass was in the money. Whatever bet he had made, Bear owed him $5 million. He used to work at Bear Stearns. It’s ironic that both Paulson and Bass, who both made a killing in this, used to work at Bear.

Bass went to Goldman and said that he didn’t want to take the risk of credit from Bear, and he wanted the $5 million from Goldman and have them become the counterparty of Bear. This is at 5pm. How quickly do you expect an answer to that question? The moment that Goldman didn’t answer immediately, Bass got the word out that he was nervous about Bear. He may have been pulling his money out of Bear, or he may have been shorting them.

**KREBS:** Agencies who have looked at this are not able to find any evidence of coordination in this.

**COHAN:** Somebody made a lot of money on the short-dated puts. They were entered Friday, the week before. The irony is that they ended up getting hosed, because the debt was taken out at par. The people who really made the money are the people who bought the short-dated puts. Whether it was Kyle Bass, Goldman, or people who have Goldman’s money, no one knows.

By not answering Bass right away, Goldman set things into motion. But I think it didn’t matter. The “I’ve got to check” was all that Kyle Bass needed. He made a lot of money, but he won’t talk to me.

**KREBS:** Is there anything that you missed in your book with regard to Bear?

**COHAN:** I’ve thought about it a lot. I didn’t see how interconnected it all was and where it was leading to. It would have been nice to get more from the SEC’s perspective. I spent plenty of time with Geithner, but there was so much to talk about.

Ace Greenberg would not talk to me, in part because he was writing his own book. I think he wants to come off as avuncular, but I think there’s more to him than meets the eyes.

**KREBS:** Have you had any folks come back to you?

**COHAN:** I’ve had two board members say to me that (1) they learned a lot and that they were shocked how much they learned and that they cannot believe that they learned something from the book and (2) if they had known then what they found out in the book, they would have done things differently.

But Jimmy did what other CEOs did—he controlled the agenda, controlled what they talked about, controlled the information. So many of them were out of their league and were just friends with Jimmy. Even Fred Solarno, the CFO of Verizon, tried to do the right things, but he wished in retrospect that they had been more forceful. Teasey (sp?) would also be good to talk to.

**WARREN:** Would Fred be good to talk to?

**COHAN:** Absolutely. I used to work with him. He’s a very high integrity guy. I think he’s going to be a lot more reflective now.

There’s the view along the way. What they should have done along the way. But then there’s also the view about what they did at the end, which was a lot.

I still don’t know what really happened with the Wachtel legal drafting that allowed them to screw up the way that the vote would work and let Bear go from $2 to $10 a share. It was the way it was drafted. They realized on Monday morning that the stock was trading up through $2 a share, and that JPMorgan would be on the hook for Bear’s trading book. Jamie Dimon woke up and realized it wasn’t working right, and he blamed it on Wachtel. But everything I know of Wachtel is that they do exactly what they’re told to do.

But then there’s been a shareholder lawsuit recently that cites my book and Sorkin’s reporting, and JPMorgan argues that’s not what happened. The one person that I never got to talk to that I’d love to talk to would be the Wachtel lawyer.

**KREBS:** Who were the strong middle managers?

**COHAN:** Marano was clearly a leader and ran the mortgage business.

**KREBS:** I asked Marano about the meetings with the other members of the staff about dumping the mortgages, and he said that it was part of a healthy debate that they were always having.

**COHAN:** We’ll never know whether in retrospect, it was so bad, or whether there was a legitimate difference of opinion about buying opportunities.

They weren’t criminal, but they were stupid and greedy. The culture at Bear was not to be particularly innovative, but to find a business that made a lot of money and put the scarce capital into it. Bear would never put capital into anything—they invested in the mortgage business because it was a proven winner.

Nobody had any incentive to call this into question. They had revenue-based compensation. They didn’t run Bear like a public company; they ran it like five guys at the top making bets with other people’s money.

**KREBS:** Is there anyone we should drill down into?

**COHAN:** The key to the whole place is Warren. He’s the sphinx. He’s not going to volunteer a whole lot. I was shocked that he didn’t have to testify in that case.

**WARREN:** Who outside of Bear would you want to talk to about Bear?

**COHAN:** Paulson and Bass both know the firm well. David Einhorn too. ACA management selected the securities that were in Abacus. They were the single largest shareholder. It was in the flip book from 2007 about that deal. BSMB (Bear Stearns Merchant Banking) transformed ABA from being a municipal bond insurer to taking positions in CDOs.

If you’re totally long like Bear was, those structures don’t interest you. If you’re short like Goldman, you’ll be more interested in that. Synthetic CDOs are one of the more intellectually interesting products. Synthetic CDOs allow you to make a security overnight.

If there’s more, let me know. The book took me 8 months. The Goldman book will be out next year.

**KREBS:** Who was most upset by the book?

**COHAN:** Ace was mad by what Jimmy said about him. Jimmy was mad about how he was portrayed. Paul is a good guy, and the reason he said everything to me is because he wanted everyone to know what happened. But now that he’s working with Schwartz, he might become slightly more circumspect.