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**Financial Crisis Inquiry Commission**
**DRAFT**
**M E M O R A N D U M**

**TO:** All Commissioners

**CC:** Wendy Edelberg, Greg Feldberg, Gary Cohen

**FROM:** Chris Seefer, Carl McCarden

**DATE:** September 17, 2010

**RE:** Goldman Sachs Exposure to AIG from Transactions Excluded from Maiden Lane III and Collateral Posting Agreements with AIG and Other Counterparties

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This memo summarizes (1) the credit default swap ("CDS") protection Goldman purchased from AIG that was not part of the 11/24/08 Maiden Lane III transaction, (2) the monies received by Goldman on those CDS, (3) the net profits received by Goldman on its "matched book" (the difference between the price it charged on CDS protection sold and the price it paid AIG for CDS protection purchased), and (4) the differences between the collateral call provisions between Goldman and the counterparties to whom it sold CDS protection (i.e., Goldman's matched book counterparty) and the collateral call provisions between Goldman and AIG.

Goldman Sachs was the largest purchaser of credit default swap protection written by AIG Financial Products ("AIGFP") against super senior tranches of multi-sector CDOs ("SSCDS"). Goldman purchased 33 SSCDS from AIGFP which totaled $21 billion and represented 27% of AIG's total $78 billion SSCDS portfolio as of 12/31/07. Beginning in July 2007, Goldman demanded that AIGFP post collateral because Goldman believed the value of the underlying collateral had declined. AIG disputed the collateral calls, did not post all of the collateral demanded by Goldman, and Goldman purchased CDS against AIG to cover some of the difference. The dispute between the companies continued throughout the year and into 2008. AIG posted $2.4 billion of collateral by 12/31/07, $3 billion by 3/31/08, $5.9 billion by 6/30/08, $6.2 billion by 7/31/08, $6.8 billion by 8/31/08, and $7.6 billion by 9/16/08.[1] After receiving an $85 billion loan from the New York Fed on 9/16/08, the amount of collateral posted to Goldman increased to $11.9 billion as of 11/24/08. On 11/24/08, as part of the Maiden Lane III transaction with the New York Fed, Goldman terminated all but 10 of the SSCDS, retained $8.4 billion of collateral attributable to the terminated SSCDS and received $5.6 billion from Maiden Lane III. The $8.4 billion and $5.6 billion figures are the amounts included in Tab 39 of the public documents released during the FCIC's hearing on the role of derivatives in the financial crisis, available here: http://fcic.gov/hearings/pdfs/2010-0701-AIG-Goldman-supporting-docs.pdf.

[1] See AIG-Goldman Sachs Collateral Call Timeline & Supporting Docs, available here: http://fcic.gov/hearings/pdfs/2010-0701-AIG-Goldman-supporting-docs.pdf .

**1. AIG Posted $1.5 Billion of Collateral to Goldman on the Non Maiden Lane III Trades as of 9/15/08 and was Paid an Additional $1.9 Billion of Collateral and Termination Payments after 9/15/08**

The 10 SSCDS and CDS purchased on miscellaneous CMBS that were not part of the Maiden Lane III transaction are listed in the following chart and show that Goldman received $2.3 billion of collateral ($1.5 billion as of 9/15/08 and an additional $800 million by 11/6/08) on the 10 SSCDS and CMBS CDS as of 11/6/08.

| Non Maiden Lane III Related CDS Exposure to AIG (11/06/08) | | | |
|---|---|---|---|
| Name | Notional | Collateral Due | Collateral Posted |
| TRIAX 2006-2A A1B1 | 500,000,000 | 243,093,824 | 213,578,000 |
| ORKNEY HOLDINGS, LLC | 600,000,000 | 324,000,000 | 245,734,800 |
| ROMULUS FINANCE S.R.L. | 194,294,981 | 65,424,742 | **N/A** |
| ABACUS04-1 | 1,760,000,000 | 515,207,116 | 503,395,310 |
| ABACUS05-2 | 1,000,000,000 | 335,961,932 | 324,609,180 |
| ABACUS05-CB1 | 480,000,000 | 87,952,756 | 85,887,729 |
| ABACUS04-2 | 730,000,000 | 152,514,155 | 140,844,623 |
| ABACUS05-3 | 1,200,000,000 | 226,969,545 | 206,620,043 |
| ABACUS06-NS1 IG | 329,000,000 | - | - |
| ABAC07-18 | 470,000,000 | 328,739,422 | 308,147,741 |
| Misc. CMBS CDS | 2,002,500,000 | 321,797,064 | 271,464,113 |
| | **9,265,794,981** | **2,601,660,556** | **2,300,281,539** |

On 8/25/10, Goldman produced information that showed as of 9/15/08 Goldman had demanded $1,756,221,026 of collateral on the 10 SSCDS and the CMBS CDS. Goldman also reported that AIG had posted $7.6 billion of collateral on all CDS but was unable to determine how much of that collateral was attributable to the non-Maiden Lane III transactions. However, Goldman representatives subsequently stated during a phone call with FCIC staff that the collateral posted by AIG related to these transactions was estimated to fall between $1.4 billion and $1.5 billion.[2]

On 07/15/10, Goldman provided documents to the FCIC concerning the status of the non-Maiden Lane III trades as of 07/06/10 which included the net proceeds received for all trades terminated or unwound prior to 07/06/10 and the collateral posted as of 07/06/10.[3] The information showed that as of 07/06/10, six of the CDS and $28.7 million of the CMBS CDS had been terminated or unwound which resulted in Goldman retaining all but $21.5 million of the $2.2 billion of collateral previously posted on those six CDS and the CMBS CDS. It also showed that the four remaining CDS and CMBS CDS had a face value of $2.8 billion and that AIG had posted $1.2 billion of collateral which was the amount Goldman demanded. In short, through 7/6/10, Goldman received $3.4 billion of collateral ($1.2 billion) and termination payments ($2.2 billion)

[2] FCIC staff discussion with Goldman Representatives on 08/31/10.
[3] E-mail received from Goldman Sachs, 07/15/10 and GS MBS 00000038856.

on the 10 SSCDS and CMBS CDS that were not part of Maiden Lane III. Thus, Goldman received $14 billion from the SSCDS that were part of Maiden Lane III and another $3.4 billion on the non Maiden Lane III trades, $1.9 billion of which was received after the $85 billion New York Fed loan to AIG on 9/16/08.

**2. Most of the Non-Maiden Lane III Transactions were Proprietary Trades, i.e., Not Part of Goldman's Matched Book**

Information provided by Goldman to the FCIC on 8/9/10 shows that the SSCDS protection purchased by Goldman on the seven ABACUS CDOs and the CMBS CDS were proprietary positions, i.e., not part of Goldman's matched book.

The unmatched book included CDS on seven ABACUS transactions with a notional value of $5,969,000,000 and single name CDS on approximately 40 CMBS with a notional value of $2,002,500,000. Five of the seven ABACUS transactions, with a notional value of $5.2 billion, were executed between May and November 2005 and were related to ABACUS CDOs that referenced subprime RMBS.[4] During the first quarter of 2006, AIGFP decided that it would no longer provide CDS protection on CDOs that referenced mezzanine subprime RMBS. Subsequently, AIGFP sold Goldman credit protection on two ABACUS CDOs that only referenced CMBS, totaling $800 million.

The information provided by Goldman on 7/15/10 shows that as of 7/6/10, Goldman received (1) $1,756,460,313 on four of the ABACUS CDOs that have been terminated, (2) $1,176,914,611 of collateral on three ABACUS CDOs and CMBS CDS that have not been terminated, and (3) $28.7 million on CMBS CDS that have been terminated. Combined, Goldman has received $2,933,374,924 from AIG on proprietary positions through 7/6/10. Thus, $2.9 billion of the $3.4 billion Goldman received from AIG on non Maiden Lane III trades were proprietary trades and not part of Goldman's matched book.

**3. Goldman Earned Approximately 3.25 Basis Points on Its Matched Book**

Information provided by Goldman to the FCIC on 7/16/10 (attached hereto) shows that Goldman recorded "Day 1 net revenues" of $24.8 million on a matched book (primarily Maiden Lane III CDS) with a notional amount of $16.9 billion which represented the present value of the 3.25 bp spread between the price Goldman charged for CDS protection and the price it paid AIG for the CDS protection.[5]

[4] E-mail received from Goldman Sachs, 07/16/10 and GS MBS 0000038856.

[5] Day one net revenues is an estimate of the present value of the net proceeds received by Goldman over the lifetime of the TRS and CDS contract, typically five years. which are recorded when the contracts are executed.

FCIC staff asked Goldman Sachs to produce documents disclosing the price that Goldman charged to counterparties in the total return swap transactions ("TRS") that were written back-to-back against the purchases of CDS protection from AIG, "matched book."[6]

On July 16, 2010, Goldman provided the information requested and the following explanation: "For each of the back-to-back TRSs, Goldman Sachs paid the TRS counterparty a spread in return for the economic exposure to the bond referenced in the TRS. The "Financing Spread" column shows this spread in bps. Goldman Sachs, as the holder of the economic exposure to the bond, would receive the bond spread from the CDO via the TRS counterparty, which is listed in the column labeled "Bond Spread."[7]

The information Goldman provided to the FCIC on 7/16/10 shows that in order to offset the credit risk of the transaction, Goldman would purchase CDS protection on the referenced bond from AIG. The "CDS Spread" column shows the cost of protection paid to AIG on the referenced bond. Goldman Sachs earns the Bond Spread, less the Financing Spread and the CDS Spread. For example, in the case of the Altius Funding transaction, Goldman Sachs paid the TRS counterparties 13 bps in the TRS, and paid AIG 10 bps for the CDS protection, while receiving 25 bps from the bond, netting 2 bps. The present value of the lifetime profits from these back-to-back transactions on the trade date is reflected in the column labeled "Day 1 Net Revenues."[8] Applying a weighted average, Goldman Sachs netted approximately 3.25 bps for these trades on average, totaling $24,815,568 in present value (as of the trade date) of the expected lifetime profits for the trades. Because these trades were terminated early by the Maiden Lane III transaction, Goldman Sachs' realized gains were less, and amount to less than one tenth of one percent of the $16.9 billion notional amount of the trades."[9] Essentially, this information shows that Goldman paid AIG a weighted average of 10.1 bps for CDS protection, paid 13.2 bps to TRS counterparties, and received 26.5 bps from holding the bond, and therefore earned approximately an average of 3.25 bps on its matched book.

### 4. The Contracts Between Goldman and its Matched Book Counterparties Did Not Include "Thresholds" Like Goldman's Contracts with AIG

On July 16, 2010, Goldman provided an e-mail response that contained the terms of their collateral posting arrangements with AIG and the counterparties in their matched book. In this e-mail, Goldman explained that the majority of their collateral posting agreements are "not executed on a trade by trade basis but rather negotiated under a global ISDA (International Swaps and Derivatives Association) and CSA (Credit Support Annex)."[10] The ISDA and CSA govern the majority of derivative transactions between counterparties, including credit, interest rate, equity and foreign exchange products. Additionally, Goldman stated the collateral posting

[6] GS MBS 0000038856.
[7] E-mail received from Goldman Sachs, 07/16/10 and GS MBS 0000038860.
[8] GS MBS 0000038856.
[9] E-mail received from Goldman Sachs, 07/16/10 and GS MBS 0000038860.
[10] E-mail received from Goldman Sachs, 07/16/10.

arrangements with AIG and the other approximately 30 counterparties, who were on the other side of the trades with AIG, were driven by global ISDA and CSA provisions with those counterparties. The specific terms of these contracts varied among the different counterparties and could also be modified at any point over the duration of the transaction. [11]

Specifically regarding its contracts with AIG, Goldman stated that "the terms for collateral posting for the majority of these transactions included a threshold whereby AIG only had to post collateral to Goldman Sachs when the price on the underlying security declined by more than 6% if AIG was rated AAA, 4% if AIG had been rated AA, and 0% if rated A+ or below."[12] Due to AIG's AA rating for the majority of the period between 2007 and 2008, collateral posting between AIG and Goldman Sachs for most transactions was subject to a 4% threshold. However, according to Goldman's response, the majority of their transactions with counterparties on the other side were not subject to a threshold which resulted in Goldman Sachs making collateral postings and cash transfers that were greater than the amount of collateral that Goldman requested from AIG.[13]

4838-2529-9719, v. 2

[11] E-mail received from Goldman Sachs, 07/16/10.
[12] E-mail received from Goldman Sachs, 07/16/10.
[13] E-mail received from Goldman Sachs, 07/16/10.

**From:** Michaels, Susan [Fin] [mailto:Susan.Michaels@gs.com]
**Sent:** Friday, July 16, 2010 6:41 PM
**To:** Chris Seefer
**Cc:** Smith, Sarah [Fin]; Lee, Brian-J (FI Controllers) [Fin]; Simpson, Michael [Fin]; Fredman, Sheara [Fin]; Broeckel, Janet [Legal]
**Subject:** Response to FCIC Hearing requests

Chris,

The following is the response to the question from the hearing about the difference in terms for trades with AIG as compared to the other counterparties.

**Question**: Were the collateral posting agreements between AIG and the counterparties we sold protection to on the other side of the trade the same?

**Response**: Most collateral posting arrangements with counterparties are not executed on a trade by trade basis but rather negotiated under a global ISDA and CSA (Credit Support Annex). The ISDA and CSA typically govern all derivative transactions with the counterparty**,** including credit, interest rate, equity and foreign exchange products. Both the collateral posting arrangements with AIG and the other approximately 30 counterparties we traded with on the other side were driven by global ISDA and CSA provisions with those counterparties. The specific terms, as reflected in the confirmations of these contracts, would have been negotiated individually between the parties to the agreement and may have been modified throughout the duration of the transaction.

Specifically, the terms for collateral posting for the majority of these transactions included a threshold whereby AIG only had to post collateral to Goldman Sachs when the price on the underlying security declined by more than 6% if AIG was rated AAA, 4% if AIG had been rated AA and 0% if rated A+ or below. Given AIG's rating between 2007 and 2008, collateral posting between AIG and Goldman Sachs for most transactions was subject to a 4% threshold during most of that period. On the other hand, the majority of our transactions with counterparties on the other side were not subject to a threshold. Overall, for most of that period the collateral posting and cash transfers Goldman Sachs made to counterparties were greater than the amount of collateral that we called for from AIG.

The following is a response to a question raised at the hearing regarding the amounts charged for the trades with AIG and other counterparties.

**Request**: The Commission has asked for Goldman Sachs to show the price that was charged to counterparties in the total return swap transactions ("TRS") that were written back-to-back against the purchases of CDS protection from AIG, and the price that AIG charged for protection on the referenced bonds.

**Response**: We have attached a spreadsheet (bearing production number GS MBS 0000038860) that provides the information requested. For each of the back-to-back TRSs, Goldman Sachs paid the TRS counterparty a spread in return for the economic exposure to the bond referenced in the TRS. The "Financing Spread" column shows this spread in basis points. Goldman Sachs, as the holder of the economic exposure to the bond, would receive the bond spread from the CDO via the TRS counterparty, which is listed in the column labeled "Bond Spread".

In order to offset the credit risk of the transaction, Goldman Sachs would purchase CDS protection on the referenced bond from AIG. The "CDS Spread" column shows the cost of protection paid to AIG on the referenced bond.

Goldman Sachs earns the Bond Spread, less the Financing Spread and the CDS Spread. For example, in the case of the Altius Funding transaction, Goldman Sachs paid the TRS counterparties 13 bps in the TRS, and paid AIG 10 bps for the CDS protection, while receiving 25 bps from the bond, netting 2 bps. The present value of the lifetime profits from these back-to-back transactions on the trade date is reflected in the column labeled "Day 1 Net Revenues".

As you can see, applying a weighted average, Goldman Sachs nets less than 3.25 basis points for these trades, totaling less than $25 million in present value (as of the trade dates) of the expected lifetime profits for the trades. Because these trades were terminated early by the Maiden Lane III transaction, Goldman Sachs' realized gains were even less, and amount to less than one tenth of one percent of the $16.8 billion notional amount of the trades.

We would welcome the opportunity to walk you through the attached spreadsheet and answer any of your questions.

Please note the following:

The Goldman Sachs Group, Inc. ("GS Group") used various technology and manual resources to generate some of the documents for production to you in response to your requests. While GS Group believes that these documents are reasonably accurate, we cannot make an absolute representation that it is complete or that there are not some inadvertent errors in the preparation of the spreadsheet. We will provide further updates or corrections if we discover missing information or errors.

Additionally, pursuant to Section 5 of the Fraud Enforcement and Recovery Act of 2009, Pub. L. No. 111-21, 123 Stat. 1617, we hereby request on behalf of GS Group that this letter and the material to which it refers be maintained in a secure manner and not be disclosed to the public, including in response to any request under the Freedom of Information Act, 5 U.S.C. § 552. If you wish to release any of these documents publicly, GS Group respectfully requests reasonable advance notice of your intent to do so and the opportunity to object to, or to seek to limit, such a release.

Please confirm receipt.

Regards,

Sue

| Cusip | Reference Obligation | Notional | Effective Date | Bond Spread | Financing Spread | CDS Spread | Duration | Day 1 Net Revenues |
|---|---|---|---|---|---|---|---|---|
| 02149WAA5 | Altius Funding | 1,277,900,000 | 10-Nov-05 | 25 | 13 | 10 | 5.00 | 1,371,806 |
| 112021AB6 | Broderick CDO | 354,500,000 | 13-Dec-05 | 27 | 13 | 10 | 4.88 | 620,737 |
| 112021AC4 | Broderick CDO | 485,000,000 | 13-Dec-05 | 27 | 14 | 10 | 4.67 | 600,336 |
| 112021AA8 | Broderick CDO | 250,000 | 13-Dec-05 | 27 | 13 | 10 | 4.92 | 442 |
| 216444AA7 | COOLIDGE FUNDING, LTD. | 274,700,000 | 22-Jun-05 | 14 | 0 | 10 | 4.56 | 501,053 |
| 264403AJ5 | Duke Funding | 129,650,000 | 12-Aug-04 | 35 | 16 | 11 | 5.55 | 596,287 |
| 264403AK2 | Duke Funding | 100,000 | 12-Aug-04 | 35 | 16 | 11 | 5.55 | 460 |
| 26545QAQ2 | Dunhill ABS CDO | 327,000,000 | 16-Dec-04 | 32 | 14 | 11 | 3.90 | 891,667 |
| 26545QAA7 | Dunhill ABS CDO | 250,000 | 16-Dec-04 | 32 | 14 | 11 | 3.90 | 682 |
| 34958CAA2 | FORTIUS FUNDING LTD | 390,000,000 | 17-Apr-07 | 27 | 9 | 14 | 2.13 | 324,804 |
| 37638VAG8 | Glacier CDO | 324,800,000 | 12-Oct-04 | 33 | 14 | 11 | 3.53 | 917,064 |
| 37638VAA1 | Glacier CDO | 100,000 | 12-Oct-04 | 33 | 14 | 11 | 3.50 | 280 |
| 442451AA8 | HOUTB061 CDO | 825,000,000 | 2-May-06 | 25 | 13 | 8 | 4.64 | 1,355,112 |
| 446279AA9 | Huntington CDO | 406,500,000 | 29-Mar-05 | 27 | 14 | 10 | 4.73 | 568,997 |
| 446279AC5 | Huntington CDO | 250,000 | 29-Mar-05 | 27 | 14 | 10 | 4.71 | 349 |
| 46426RAA7 | Ischus CDO | 213,750,000 | 27-Jul-05 | 27 | 14 | 10 | 5.32 | 309,055 |
| 46426RAB5 | Ischus CDO | 50,000,000 | 27-Jul-05 | 27 | 15 | 10 | 5.19 | 61,954 |
| 48206AAG3 | Jupiter High-Grade CDO | 1,299,500,000 | 10-Aug-05 | 27 | 13 | 10 | 5.30 | 2,554,747 |
| 48206AAA6 | Jupiter High-Grade CDO | 250,000 | 10-Aug-05 | 27 | 13 | 10 | 5.30 | 505 |
| 498588AC6 | Kleros Preferred Funding | 869,500,000 | 10-Jan-06 | 27 | 12 | 10 | 5.25 | 2,064,454 |
| 498588AA0 | Kleros Preferred Funding | 250,000 | 10-Jan-06 | 27 | 12 | 10 | 5.25 | 595 |
| 52902TAC0 | Lexington Capital | 199,500,000 | 25-Oct-05 | 28 | 12 | 10 | 3.47 | 382,408 |
| 52902TAE6 | Lexington Capital | 250,000 | 25-Oct-05 | 28 | 12 | 10 | 3.47 | 479 |
| 58936RAB3 | Mercury CDO | 299,800,000 | 3-Nov-04 | 34 | 15 | 11 | 4.20 | 925,503 |
| 58936RAA5 | Mercury CDO | 100,000 | 3-Nov-04 | 34 | 14 | 11 | 4.94 | 416 |
| G6177YAA0 | MKP CBO | 140,000,000 | 7-Apr-04 | 39 | 14 | 11 | 2.80 | 548,678 |
| 68571UAA7 | Orchid Structured Finance CDO | 113,750,000 | 19-Apr-05 | 36 | 15 | 12 | 3.28 | 350,435 |
| 68619MAJ0 | Orient Point | 250,000 | 25-Oct-05 | 27 | 13 | 10 | 6.36 | 562 |
| 68619MAQ4 | Orient Point | 649,750,000 | 25-Oct-05 | 27 | 13 | 10 | 5.39 | 1,238,248 |
| 68619MAL5 | Orient Point | 647,250,000 | 25-Oct-05 | 27 | 15 | 10 | 5.03 | 641,164 |
| 76112CAB4 | Reservoir Funding | 374,800,000 | 26-Oct-04 | 35 | 16 | 11 | 3.93 | 1,284,417 |
| 76112CAA6 | Reservoir Funding | 100,000 | 26-Oct-04 | 35 | 15 | 11 | 4.88 | 466 |
| 768277AA3 | River North CDO | 149,750,000 | 19-Jan-05 | 33 | 15 | 11 | 5.69 | 596,543 |
| 80410RAA4 | Saturn Ventures | 267,750,000 | 9-Jun-05 | 27 | 11 | 10 | 3.06 | 491,205 |
| 82437XAA6 | Sherwood Funding CDO | 322,250,000 | 15-Dec-05 | 28 | 14 | 10 | 5.71 | 700,004 |
| 83743YAS2 | South Coast Funding | 773,500,000 | 25-May-05 | 26 | 14 | 10 | 5.06 | 957,843 |
| 83743YAB9 | South Coast Funding | 250,000 | 25-May-05 | 26 | 14 | 10 | 5.06 | 314 |
| 83743LAC5 | South Coast Funding | 344,500,000 | 25-Jan-06 | 32 | 12 | 14 | 4.81 | 1,050,748 |
| 83743LAA9 | South Coast Funding | 250,000 | 25-Jan-06 | 32 | 12 | 14 | 3.30 | 523 |
| 896008AB5 | Triaxx Prime CDO | 1,399,850,000 | 14-Dec-06 | 26 | 12 | 11 | 4.94 | 1,782,085 |
| 896008AC3 | Triaxx Prime CDO | 1,399,850,000 | 14-Dec-06 | 26 | 14 | 11 | 5.88 | 675,963 |
| 896008AC3 | Triaxx Prime CDO | 100,000,000 | 14-Dec-06 | 26 | 14 | 11 | 5.88 | 48,288 |
| 896008AB5 | Triaxx Prime CDO | 100,000,000 | 14-Dec-06 | 26 | 12 | 11 | 4.94 | 127,305 |
| 952186AA2 | West Coast Funding | 1,187,950,000 | 26-Jul-06 | 22 | 13 | 8 | 3.95 | 703,814 |
| 952186AB0 | West Coast Funding | 1,187,850,000 | 26-Jul-06 | 22 | 15 | 8 | 6.34 | (433,229) |
| | | **16,888,550,000** | | | | | | **24,815,568** |