Testimony from David Lehman
Managing Director
Goldman Sachs & Co.
Financial Crisis Inquiry Commission
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Chairman Angelides, Vice Chairman Thomas and Members of the Commission:

Good morning. My name is David Lehman. I am a Managing Director at Goldman Sachs and the co-head of the Structured Products Group Trading Desk, a position I have held since 2006.

I understand that the Commission is interested in my role in connection with the collateral dispute between Goldman Sachs and AIG. As the Commission is aware, Goldman and AIG were counterparties in a number of credit default swap transactions referencing Collateralized Debt Obligation, or CDO, securities. The value of these transactions began to decline as a result of a significant dislocation in mortgage markets that occurred starting in the summer of 2007. Beginning in late July 2007, a dispute arose between Goldman Sachs and AIG concerning the amount of collateral that AIG needed to post as a result of a decline in the market value of these transactions.

I became involved in the collateral dispute with AIG in late July 2007. My role focused on providing Goldman internally, and ultimately AIG, with pricing for these transactions and the rationale for such pricing, as well as to try to gain an understanding from AIG of their pricing and the rationale for their pricing.

Goldman made a collateral call to AIG in late July 2007 that demanded that AIG post approximately $1.8 billion in collateral. In connection with the collateral calls issued to AIG in late July (and thereafter), I and others from my trading desk were involved in Goldman's pricing of the CDO positions. Goldman's prices were formed by diligently observing and reviewing the best available information from the market through its role as a market maker.

Shortly after the initial collateral call, I participated in a telephone conference with AIG in which both sides discussed the dispute. Despite a very volatile July, AIG questioned our lower prices, not believing their securities had lost much value. We were firmly of the belief that the marks should represent as accurately as possible the market prices for these transactions based on our experience, expertise, and the market information available to us.

A market price is simply the price at which a security could be bought or sold in the market. But unlike the stock market, where there are frequent transactions in the stocks for the various companies that trade on the exchange, certain mortgage instruments trade infrequently, even when the market is considered liquid.

Because there were infrequent or no trades in the particular credit default swaps between AIG and Goldman, we based prices for these positions on two main sources: (1) the prices of comparable transactions that were trading in the market; and (2) pricing information we could obtain from market participants through bid or offer requests for similar securities or credit derivatives to the extent that those bids or offers constituted real, actionable prices at which market participants were willing to trade.

As an example of a comparable transaction, Goldman Sachs might observe a trade in a security with a similar risk profile, similar structure, and containing similar, but not exactly the same, mortgages. Or, we might execute a transaction in otherwise similar derivatives, but backed by mortgage loans from a different time period (e.g., mortgage loans from 2006 versus 2005). We would collect the information generated by these comparable transactions. Then, we would perform a variety of analyses on the collected comparables in order to gain a sense of the market value of the Goldman/AIG swaps from the pricing reflected in actual market transactions in similar derivatives.

Crucial to the pricing process is having accurate market information. Non-actionable prices—prices at which the quoting participant is not willing to trade—are not indicative of the market. Our marks were based on actionable prices, informed by market information from comparable transactions.

At various times during the dispute, Goldman was willing to, and did, receive less than it was entitled to from AIG as a partial payment of its collateral demand. The Firm did not, however, reduce its collateral demands to the levels AIG posted, but instead kept its demand at the levels established by pricing determinations.

Indeed, for most of the AIG transactions, Goldman entered into swaps with other parties that offset the risks that the Firm had taken through its transactions with AIG. These offsetting trades meant that Goldman was itself required to post collateral to the counterparties to whom it had sold credit protection, just as Goldman expected AIG to post collateral to it.

Throughout the collateral dispute, we continued the process of pricing our positions and demanding collateral from AIG consistent with that pricing. AIG continued to dispute our marks, but for almost 6 months, AIG refused to provide Goldman Sachs with its marks on these same positions. In addition, during this time period, our dialogue with AIG often focused on third party marks that were neither actionable nor indicative of the market.

The collateral call dispute between Goldman Sachs and AIG continued throughout most of 2008. We offered, at various times, to transact with AIG, or other interested market participants that AIG was aware of, at prices consistent with those that we were using to calculate the collateral amounts. AIG never took us up on this offer. Personally, I remain very confident that the prices we used represented accurate market prices for those transactions at the time.

Mr. Chairman, thank you for the opportunity to appear before you and the Commission today. I will gladly answer any questions that the Commission may have.