Testimony from Gary D. Cohn
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Before The Financial Crisis Inquiry Commission
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Chairman Angelides, Vice Chairman Thomas and Members of the Commission:

Thank you for the opportunity to contribute to the Commission's work to understand the causes of the financial crisis. I would like to begin my testimony with an apology. You have stated that we have not been sufficiently responsive to the FCIC's requests for information. We apologize for any failure on our part.

We have re-doubled our efforts to provide the documents and information you want, roadmaps to those documents and extensive engagement with your staff. We recognize the significance of your mission to examine the underlying causes of the financial crisis and we will work hard to help you fulfill it.

In examining the crisis, one area that has attracted considerable attention has been derivatives. Although derivatives can be complex, in essence they are no different from any other financial instrument or product. Derivatives are used to lock in prices and to hedge – or protect – against events like generalized inflation or credit risk associated with a company.

As the name "derivative" implies, these types of instruments *derive* their value from prices of underlying assets, like stocks, bonds, commodities, interest rates or mortgages. For a financial intermediary like Goldman Sachs, activity in derivatives is inter-related with our activity in the underlying instruments. Whether we are calculating the value of our positions, marking our books or managing our risk, we look at our operations in aggregate, which means we include cash and derivatives. This is important because it goes to the heart of how we view risk. Concentrations of risk within financial institutions can be very dangerous, but they can be brought about through the most basic of products – like bank loans or mortgages – as was the case with many institutions that failed in 2008.

There is no question that managing a large derivatives business requires an effective operational infrastructure and a commitment to prudent risk management. For Goldman Sachs, the cornerstone of risk management is fair value, or mark-to-market accounting. Every business day, we produce a profit and loss statement for the firm and this reflects changes in the fair value of our entire book of business.

This commitment to fair value accounting in all types of markets is important with respect to at least two issues. The first is AIG.

We bought credit protection from AIG against the value of financial instruments on which we, acting as an intermediary, had provided protection to other clients. As the housing market deteriorated, Goldman Sachs began to mark down the value of some of those positions. We believe that our marks reflected the realistic value that the market was placing on these securities and the price at which we and others were willing to trade.

The mark downs resulted in collateral calls to AIG, consistent with our mutual agreements. We did not call for collateral because we anticipated the eventual scale of AIG's problems. We simply stuck to our risk management protocols. Because AIG disputed some of our collateral calls, we spent a considerable sum of our shareholders' money to insure against the risk that AIG would not pay us in the event of a default.

When the government intervened, it did so to prevent a further destabilizing of the financial system by enabling AIG to meet its contractual obligations. While every market participant benefitted from the government's actions, we took our own steps, from the very beginning, to protect our shareholders.

The second area where marking to market proved vital was in the residential mortgage-related market. Although this business accounted for less than 1 percent of our net revenues in 2007, a lot of attention has focused on our decision to reduce risk in this area beginning in December 2006. There is a view, perhaps, that we anticipated the crisis to come. We did not.

In fact, there were many different views within our firm, let alone in the wider market, as to the future direction of housing prices and the value of mortgage securities. But, having observed a series of daily losses in our Mortgages business through the daily marking to market of our positions, it seemed prudent to reduce our net exposure to the subprime residential housing market.

Again, this was not the result of any special foresight or any factor other than an adherence to our risk management protocols. When a pattern of losses occur in a business, we attempt to reduce our risk.

Some have questioned whether our decision to have less risk in the mortgage space should have prevented us from transacting with clients who had a different view of housing prices, securities, risk, market direction, or some other factor. We transact every day with clients who have a different view of the world than we may. They expect us to execute for them, and to provide our best prices regardless of market conditions or other factors.

Given the focus and the seriousness of the charge that "bets" were made against certain clients, we have reviewed every RMBS and CDO that we underwrote from December 2006 to today. Among other things, we examined the short positions the firm acquired in connection with those underwritings.

During the period, we underwrote approximately $14.5 billion of CDOs. At the end of June 2007, we held approximately $2.4 billion of bonds issued by these CDOs. Against this, we bought protection representing about 1 percent of the total amount underwritten. It is also worth noting that nearly 60 percent of the cash bonds and synthetic-risk sourced to allow investors to assume short side risk in these CDO transactions came from institutions other than Goldman Sachs.

In the same period, the firm underwrote nearly $47 billion of RMBS. At the end of June 2007, we held about $2.4 billion of bonds issued by the RMBS securitization trusts. Again, the total amount of credit protection we bought was approximately 1 percent of the amount underwritten.

During the two years of the financial crisis. Goldman Sachs lost $1.2 billion in its residential mortgage-related business. We did not “bet against our clients”, and the numbers underscore this fact.

It is always useful with hindsight to examine actions taken. Of course, we regret that we did not do many things better: like having less exposure to leveraged loans, which caused us approximately $5 billion in losses, having less exposure to mortgages, and, it should go without saying, we wish we had seen more proactively the effects of the housing bubble.

We believe that the most important conclusions from a review of the crisis are that the system and individual institutions needed more capital, more liquidity, more transparency and better risk management. We are hopeful that the regulatory reform that is in its final stages before passage will help make our financial system healthier and more resilient.

Mr. Chairman, thank you, once again, for the opportunity to appear before you today and I look forward to answering the Commission’s questions.