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FCIC memo of staff interview with Steve Eisman

Steven Eisman

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MEMORANDUM FOR THE RECORD ("MFR")

Event: Interview with Steve Eisman of FrontPoint, LLC

Type of Event: Interview

Date of Event: April 22, 2010 10:00 a.m. - 12:00 p.m.
Follow-up call, April 28, 2010

Team Leader: Chris Seefer

Location: Offices of FrontPoint LLC, 1290 Avenue of the Americas, 34th Floor, New York, NY 10104

Participants - Non-Commission: Steve Eisman, Reg Brown (Wilmer Hale), D. Scott Tucker (Morgan Stanley)

Participants - Commission: Chris Seefer, Kim Schaefer, Clara Morain

MFR Prepared by: Clara Morain

Date of MFR: April 27, 2010

Summary of the Interview or Submission:

Chris Seefer opened the meeting by briefly summarizing the FCIC's mandate, specifically its charge to investigate the role of credit derivatives in the financial crisis. He thanked Mr. Eisman for making time to speak with the Commission staff and said that he was interested in hearing Mr. Eisman's views on the causes of the crisis generally, on the role of subprime mortgage credit derivatives in the crisis, and any recommendations Mr. Eisman had on topics or individuals the FCIC should pursue during its investigation.

Mr. Eisman offered that no one the FCIC has spoken to so far "has a clue," and that "all of CEOs are clueless," with the *possible* exception of Lloyd Blankfein. He said that CDOs and CDS "are an important story," but not necessarily the central story to the financial crisis. He said that fundamental causes of the crisis started in the 1990s with two big events: 1) the shift to measuring leverage on a risk-weighted basis, and 2) the creation of the shadow banking system.

Mr. Eisman said that the financial system's current method of measuring leverage amounted to "some kind of gobbledygook," and created a system in which "leverage in Europe triples, and goes up by two times in the US, but on a risk-weighted basis, risk is flat so no one thinks there is too much risk. Turns out all risk weightings are wrong. And no one imagined losses as high as they were."

Mr. Eisman added that “Alan Greenspan is the worst Chairman of the Fed in history,” and that he allowed “basically no regulation whatsoever and basically allows a shadow banking system [to grow] which is a way, really, to get things off balance sheets, to hide risk, to keep risk away from regulators.” Kim asked how Mr. Eisman defined shadow banking, and he replied that “anything not on a bank balance sheet” is shadow banking.

Continuing to describe the fundamental causes of the crisis, Mr. Eisman said that “so after the last recession, you enter into [2001-2002] with ever-[increasing] leverage in the system, and no one knows.” Then, he said, “we’re at subprime. And the subprime story hasn’t been told well. So I’ll tell it.”

He said that the subprime story starts when Chairman Greenspan lowers interest rates to one. “This creates an insatiable demand for yield,” he said, “and the thing that has the most yield is subprime. So there’s a higher demand for subprime than usual. And here’s where we get to the first stage of the great calamity: there are two types of subprime loans – fixed rate and a 2/28 or 3/27,” the so-called teaser-rate subprime loans. “Anybody who knew anything about how subprime lending works knew that underwriters always underwrote to the teaser rate – that is, the customer could only afford the teaser rate, meaning the customer needs to refinance as reset dates get closer,” he said. Noting that all “first generation” subprime lenders (e.g. AIMs, Money Store, Greentree, Conti) were bankrupt by 1998 with the notable exception of New Century – “gain on sale” accounting was part of the problem -- Mr. Eisman said that the second generation of subprime lenders learned that they could sell their loans to Wall Street to securitize, and that there was no downside when loans are designed so that customers are unable to pay their principal. A subprime loan is “an ethically horrendous loan. But perfectly legal,” he said.

Mr. Eisman said that the ratings agencies are the subject of the next part of the subprime story. He explained that the ratings were problematic because 1) they were wrong, and 2) they awarded higher ratings to riskier loans. “So now the ratings agency models modeled fixed-rate and 2-28s and 3-27s. When they modeled fixed-rate loans, it was easy – [they were] only modeling losses. In adjustable-rate loans, there were also assumptions about how much of the pool would refi[nance] and of the loans not re-financing, how high would the losses be. Here, the model got it wrong. It assumed pre-payment speeds of about 40%-50% and higher losses for the remaining people. Turned out that 80-90% [of borrowers] prepay with much, much higher losses among of people left,” he said. Mr. Eisman also explained that because an adjustable-rate 2-28 or 3-27 mortgage had a higher cash flow than a traditional, fixed-rate loan, “from a cash-flow perspective, the adjustable rate mortgages were better” than traditional loans. Accordingly, the ratings agencies awarded more triple-A credit the more adjustable-rate mortgages comprised a pool of loans. “If you tell a bank that you get more triple-A credit the more 2-28s are in the pool, there’s no question what they’re going to buy more of,” Mr. Eisman said.

“So they produce adjustable-rate mortgages,” he said. “The problem was, the whole system worked fine as long as everyone could refinance. The minute refis stopped, losses would explode. In [2002-2005] credit came in better than expected because everyone was refinancing. You tell an underwriter credit is better than expected, [and they relax] standards. So by 2006 about half were no-doc or low-doc. You were at max underwriting weakness at max housing prices. And so the system imploded. Everyone was so levered there was no ability to take any pain… and the rating agencies were told that the ratings were all wrong. But they did nothing to change the models until way too late,” he said.

Chris then asked Mr. Eisman to clarify why the models were wrong and why the models rated adjustable-rate loans higher than traditional mortgages. “It just was wrong,” he said, and explained that rating agency models contained 1) inaccurate assumptions about pre-payment rates, and 2) inadequate loss projections for borrowers who did not refinance when their interest rates reset. “The data – the pre-payment speeds were much, much higher, and losses remaining on those who didn’t re-fi were much, much higher than for the people who [did]. [The models] assumed lower prepayment speeds, and of [those in the] remaining pool, higher losses - but not five times higher,” he said. He explained that risky loans obtained higher credit ratings because “the models said the cash flow was bigger for [subprime loans], and the more cash flow, the more triple-A we’ll give you.”

Chris asked if Oppenheimer had accurate models to analyze subprime lenders. Mr. Eisman said, “you know, when I started out as an equity analyst, we had no securitization data. We relied on company data. For $10,000, I got access to the Moody’s database and we compiled data and found out – you know, the biggest assumptions were about what the losses would be, and how long loans would last… Our data showed that pre-payment speeds were massive and would require massive write-offs.”

Chris asked if Mr. Eisman could be more specific about when the ratings agencies were told that their models were wrong. “One person went to the rating agencies and told them they were forcing the Street to force lenders to create these [loans], [that they were] eliminating the world of fixed rate loans,” he said. Kim asked if Mr. Eisman was referring to Joshua Rosner, and Mr. Eisman replied that “it’s someone who works for me.” He said that the ratings agencies were told that their models were wrong in 2003 or 2004, or “probably both” years. “Like I said, nothing here is criminal, it’s just stupid. I think they’re generally just stupid,” he said.

Kim then asked Mr. Eisman who the FCIC should interview. “The people who created rating agency models – [ask them]: ‘why did you have these assumptions and why didn’t you change them?’ I don’t think the rating agencies understood they were creating incentives to create that product. I come out of this from an ethical thing – I think these loans are just bad. And the regulators should really say ‘this is wrong,’ but I’m the only one who [seems to think so].” Kim asked if he recommended talking to anyone else. Mr. Eisman said, “I know for a fact people went to Greenspan and said, ‘these loans are really bad and will one day have really bad social

results.' Oh and the worst offender – the worst offender is John Dugan. There should be a special place in hell for him. Not only did he *not* care, he went *out of his way* to preempt others from doing *anything*," he said. Chris said that in the FCIC's last hearing, Mr. Greenspan said that the Fed issued guidance in response to warnings about the dangers of subprime lending. Mr. Eisman laughed and said, "ya. Exactly." Mr. Eisman said that Josh Rosner told Mr. Greenspan of the dangers of subprime lending, and "they said, 'welcome to capitalism!'"

Chris asked if Mr. Eisman could provide any more color on the OCC's pre-emption efforts, and Mr. Eisman said he couldn't. Chris asked if he thought it would be worthwhile to talk to the OCC, and Mr. Eisman said, "I don't know, what would be the point? Why would you talk to Dugan? It's like talking to the devil."

Chris said that he wanted to go into issues relating to CDOs and CDS, and summarized his understanding of Mr. Eisman's participation in the CDS market – that he came to FrontPoint in 2004 and saw that the housing market did not look good. Then, Greg Lippman met with them in the spring of 2006 and said, 'here's the wonderful world of CDS,' and then FrontPoint met with investment banks and began participating in the CDS market. Mr. Eisman clarified that he met with Goldman Sachs in 2007 and did a trade with them in the spring of 2007; that he talked to Mr. Lippman from the Spring of 2006 until October of 2006, and that he met with Bank of America and Citi, "but they were pretty incompetent," he said. He said that all of the trades involved synthetic subprime MBS. He said that he "never really did ABX" and that "we always wanted to pick our paper. We always looked for high California and Florida content, no-doc and low-doc loans." He said that he did trades in October 2006, in December 2006, and in February 2007 after the January Las Vegas conference. He said of CDOs that he always did the A-tranche, and that he never knew who the long investor was. He said that Goldman approached FrontPoint in the spring of 2007 and as spreads tightened throughout the spring, "we did a whole bunch of trades, mostly asset back securities… [We did] lots of trades with Goldman on the CDO side."

Kim asked if Mr. Eisman knew what he knew about who was putting what in the CDO. Mr. Eisman responded that, "my entire interaction was: these were the bonds we want, give me a big ass spread. And that was it, the end of my relationship." Kim asked if Mr. Eisman would go to the investment banks with his own list of assets, and he said, "yes, generally speaking, [but] sometimes they would show me things. Like the trades with Goldman were WaMu bonds – the Long Beach bonds that WaMu owned were double the spread [of the WaMu bonds] even then they were the same crap! But people priced WaMu better just because it said 'WaMu.'"

Chris asked what investment bankers Mr. Eisman interacted with other than Mr. Lippman at Deutsche Banks. Mr. Eisman said that a Goldman Sachs salesman he interacted with was Nick Falts, David Lehman was the trader, and that he met with Jonathan Egol on only one occasion. Chris asked what the nature of that interaction was, and Mr. Eisman explained that they met in connection with a deal involving shorting CMBS in 2007. "Nick came to me in the last week of August 07 and said that they had a transaction they'd done which was an Abacus – I think Abacus 18 – and he explained it to me. It was a complicated CDO of CMBS gobbledygook – some combo of BBB-, BBB+, a smattering of AAA … I don't think there was a manager. Guys would short the triple-A and didn't want to be short that much, so they wanted to lay off some of the risk and would I like some? We'd never done anything in CMBS before. It would cost 220 basis points. I said, 'I'll do $30 million at 190 bps. They called me back, deal done at 195. A month and a half later we asked them to bring their people in because we didn't really understand what the hell the thing was. So they brought in Egol and Lehman and explained the structure. That's how I met Jonathan," he said.

Chris asked if Mr. Eisman had any documentation of his interactions with Mr. Egol or Mr. Lippman. "I don't do documentation, my friend," he said. He explained that "this has evolved because I literally can't read my own writing." Mr. Eisman said that the 2007 CMBS deal was "highly profitable. They [Goldman Sachs] explained why they didn't want to be as short as they were, they said they wanted to have somebody out there to present a mark to other than the guy who was long." Chris asked if he knew who was long, and he said, "no idea. Never asked, didn't want to know."

In response to follow up questions from Kim and Chris, Mr. Eisman said that he never saw an Abacus ever again, and that he never traded with Merrill Lynch. "We never got a chance," he said about why he didn't do a trade with Merrill. "We were big, and thought that we were big enough. We didn't need to go out and do more."

Chris asked what else he should know, and Mr. Eisman said, "stuff I don't want to tell you unless you promise I won't testify." Chris explained that he was not in a position to make that assurance, and he, Mr. Eisman and Mr. Brown agreed to discuss the matter later.

Referencing Mr. Eisman's March 2008 speech at Deutsche Bank, Kim asked Mr. Eisman to talk more about the connection of the monoline insurers to the financial crisis. "My understanding - and it's just my understanding of what happened – was that AIG was the first great seller of CDS. And when they began that, they didn't really understand that they were selling CDS on subprime paper. So the whole Street was creating CDOs and laying off the triple-A risk onto AIG. One of the more interesting aspects of the subprime securitization process – Lippman, when we met for the first time, I asked who was long, he said 'Dusseldorf.' I said later that it can't be *all* Dusseldorf. Then he'd say CDOs – there's no real buyer. The only time I really understood that was when I had dinner with Wing Chau. The buyer was the CDO who bought it synthetically and then had to lay off the risk to AIG. Then in 2005, AIG said 'no mas.' The

Street's supposed to be an originator and seller of paper, not an originator and holder of risk. So you're the [Chief Risk Officer] and the person who you're laying off risk to says 'no mas,' well you say, 'find someone else.' And they did – AMBAC, MBIA, ACA - and the problem is they're not big enough to replace AIG. So you're the CRO, so you say, 'originate less.' Well the fixed income guys weren't going to stop the machine, and anyone who tried got fired," he said, and mentioned Mr. Kronthal in the securitization arm at Merrill Lynch as an example. He continued, "so you can only lay so much on AMBAC and ACA, and so they held it themselves and justified it by saying 'it's triple'A.' And so they kept it! Turned out, it was pretty bad. So the guys who *really* blew up were Merrill, Citi and UBS, because they ate it, and they ate it *badly*."

Kim said that earlier, Mr. Eisman said that the CDO story was not necessarily the central story. "It kept the machine going because it kept the machine going – it was false liquidity in the end, it was the Street buying the paper for itself," Mr. Eisman said. "The whole system started to go down in 07," he said. "By the summer, credit quality was so bad that nobody would touch the paper, so there were no refis happening, so prepayments went from 95 to 0. The joke I had in summer of 07 was that in all of these institutions owning triple A rated stuff, the same conversation was happening on planet earth in 200 different languages between the CEO and the chief investment officer, and the conversation started with: 'We own WHAT?' And that's how the system began to freeze."

Chris said that one of the things the FCIC has been looking at is institutions like Goldman Sachs and Morgan Stanley to see if they were selling long positions to customers while taking short positions themselves. "These transactions, whatever they are, for there to be a buyer, there has to be a short. And you could argue that it should go away, but this whole world is a zero-sum game. The fact that somebody originated some CDO and sold it to Dusseldorf and itself shorted the paper is not itself the indictment. Come back, tell me I won't testify, and I'll tell you the story," he said.

Kim noted that there was a limited amount of cash subprime paper, after which point everything moved to synthetic to create more of it, and asked if the creation and growth of those synthetic instruments was a cause of the financial crisis. "No question. Not even debatable," he said. "Why? Because the whole CDS – look, if you want to go short IBM, you go to Goldman… you get the stock, you sell it, that's the end of your relationship and you can't short more than the flow, it's physically impossible… The problem with the CDS world – let's say I bought $100 million of protection of GE through Goldman Sachs. For me to collect, I need Goldman Sachs. Our ability to get paid depends on Goldman Sachs's ability to pay. It means institutions across the world have balance sheets tied to everyone else. The equity markets traded throughout. The fixed income market stopped because nobody could trust, and *that's* because of CDS."

Kim asked if Mr. Eisman differentiated CDS from other OTC derivatives, and he said no, that it's "all in the same universe. Anything that ties a balance sheet to everyone else." He added, "My opinion? All that stuff should clear centrally."

Chris asked him about his experience with Deutsche Bank, and Mr. Eisman said, "Good bid spread. Treated me honorably. I have no negative stories about Deutsche Bank, period." Mr. Eisman also said that Mr. Lippman would be a good person to talk to as part of the FCIC's inquiry.

Kim asked Mr. Eisman to comment on the conference call he hosted on July 17, 2007. "The whole world was on that call," he said. He explained that it was supposed to be a call with FrontPoint investors, but that "In my infinite wisdom, I said 'I want the whole world to know.' So I'm told there were 500 people on the call, could've been 500 on top of that. Most questions were from other hedge fund people." He said that the tape of that call likely exists, and that there was a PowerPoint deck created by Mike Kelly that would still be available.

Kim asked who other than Mr. Eisman were critics and dissenting voices about the market. "There's Josh [Rosner], there's us. There weren't that many people. A woman who used to head mortgage research at Deutsche Bank . She was head of mortgage research. Karen Weaver. She was good. She understood everything that was still going on." Mr. Eisman said that Ms. Weaver might still be at Deutsche Bank, but that he does not know one way or the other.

Kim asked if Mr. Eisman had a view of the quality of mortgage research and fixed income research. "Everyone really did believe that things were going to be ok," he said. "[I] thought they were certifiable lunatics." Mr. Eisman said that people still believed "the Kool-Aid that housing prices never go down" until 2007. "There was a whole thesis – the burnout thesis – which was, ya the delinquencies are high early but it's [temporary] so we'll be fine," he said.

Chris asked if Mr. Eisman had met Michael Burry, Charlie Ledley or Jamie Mai. Mr. Eisman said he recently met Mr. Burry and Mr. Ledley, but that he did not know them before. Chris asked if he knew people at Paulson & Co., and Mr. Eisman said the January 2007 Las Vegas conference was the only time he met people from Paulson. He said they attended the dinner with Wing Chau.

Kim asked Mr. Eisman if he had comments on the insights or lack of insights among analysts on the "sell side." Mr. Eisman said that he "never really interacted with ABS or CDO analysts except for on conference calls. I think I was the first time anyone was obnoxious to rating agencies before. And I was being mild. The financial services analysts didn't understand. And to their credit, the disclosures about the firms were so poor, it was pure guesswork. This was all a fixed income game," he said.

Chris asked if any other investment banks not yet discussed approached him about doing a deal. Mr. Eisman said no, that FrontPoint couldn't do business with Morgan Stanley (because Morgan Stanley owns FrontPoint), and that he never did business with Merrill Lynch.

Chris asked if he ever declined to do a deal that Deutsche Bank or Goldman Sachs approached him with. Mr. Eisman said yes, that there was "some stuff we didn't do because it was too expensive." Chris asked if he ever declined to do a deal for other, ethical reasons, and Mr. Eisman said, "no, nothing like that."

Kim asked Mr. Eisman if he agreed with Michael Lewis's thesis that the shift in financial institutions from partnership structures to public ownership changed the dynamic of the market. "I basically do agree with it to a considerable agree," he said. "In one sense, there wasn't a choice…. It did change the culture to a significant degree, and [it changed the ethic to] 'I'll do whatever I can to get my bonus this year,'" he said. He said that another fundamental problem is that "management is poor and even when a guy is good, he doesn't have the authority or the guts to do what needs to get done. There is no one sitting in front of the securitization group saying 'you can't do that.'" Commenting on the complex structure of CDO and CDS deals, Mr. Eisman said that "they weren't understandable to people in the companies. There are all these SIVs out there – it was Armageddon that day. Think about it this way – you're Citicorp, you have this SIV, you've never thought about that SIV because it's not your liability, you have a small equity ownership in the SIV- probably own 3% of it and the rest is funded by debt. The thing blows up and your money market clients are screaming that if you don't make them whole, they'll never do business with you again. So you make them whole and put it on your balance sheet." He also said, "financial innovation is an oxymoron. It's very rare that there is something that's *actually* financial innovation. It's a euphemism for hiding leverage. The world needs more standardization, less innovation."

Commenting on the different tranches of the CDOs he bet against, Mr. Eisman said, "I thought it was all shit. Three levels of dog shit lower than shit." Chris asked if Mr. Eisman had those kinds of discussions with Deutsche Bank and Goldman Sachs and if "they recognized it was dog shit." Mr. Eisman said no, and that FrontPoint was in the minority. "Everyone thought it was gold," he said. Chris asked if Deutsche and Goldman thought the CDOs were "gold," and Mr. Eisman said that he never talked to anyone high up enough, but that "Lippman thought it was dog shit, [which is] why he wanted to short it. I don't know if anyone high up shared that view… Vinniar at Goldman figured out that something was wrong here and became involved – it flipped in April 2007." He said that he never talked to Vinniar, but that he knew that at some point he got involved and Goldman said to "go test the market," after which point "they turned the ship."

Chris asked if Mr. Eisman ever thought Goldman got its marks wrong, and Mr. Eisman did not recall the specific details, but said that there was one occasion when Goldman changed some assumptions on two bonds, and that was the only time he thought a mark was wrong. He said that "Merrill was the worst in terms of marking," according to what he had heard, and that it was "the worst because there were so many CDOs, they just didn't want to mark down."

Chris asked if the first quarter of 2007 decision to force companies to disclose level one, two and three assets was a significant moment for FrontPoint. Mr. Eisman said, "I couldn't say that's the big moment." He continued to say that "one of my favorite shorts was the rating agencies. Shorting Moody's was truly one of the joys of my life."

Chris asked if Mr. Eisman had any concerns about counterparty risk, and Mr. Eisman said that counterparty risk was not a concern until 2008, "but then we had western civilization risk. And I figured that Goldman and Deutsche would [still be] there. And it wasn't such a concern [because] you'd only have cash up to your last mark... So on the day you want to unwind the trade, your only trade was the cash up to last mark. It was not as much a problem for me – I was just short."

Chris asked if Mr. Eisman had any other comments on why this most recent bubble was so much larger than other bubbles in recent history. "I've said everything I have to say," he said. Kim asked if he had comments on the bubble in commercial versus residential real estate markets. "There was one, but it wasn't as big as the residential side – [it wasn't] as big a market. There weren't a lot of transactions that took place there. Prices are coming back in some places because of liquidity. It was never big enough to be a systemic issue," he said. Describing commercial real estate's impact on the already-devastated market, Mr. Eiman said, "the patient had been beaten to a pulp, it's brain had been sucked out, and then a vampire comes down and sucks its blood – but you know, the patient was already dead."

Kim asked Mr. Eisman to comment on the role of executive compensation in the financial crisis. "Forcing people to have equity is not a solution – Dick Fuld owned a billion dollars. Jimmy Cayne owned a billion and smoked doobies the whole time – and that's a fact. Stock *per se* is not a solution. I think claw backs from people who manage balance sheet risk is where you need to go. It's something that needs to be explored." As an example, Mr. Eisman said that in Brazil, directors who manage banks that end in failure are subject to a claw-back of their entire net worth. "Now, I don't know if I'd go that far…" he said, but noted that there are still banks in Brazil.

Kim asked if having an outlet to go short allowed more activity to occur in the cash market, and Mr. Eisman said that it "probably did. [It provided] more liquidity." Kim asked if Mr. Eisman had a view on the development of the ABX, and he said that "I don't think it had an impact. By the time the ABX was created it was cooked – it wouldn't have mattered, it just made the ride more exciting, but it [the market collapse] would have happened. At the same time, same date."

Chris said that he was interested in the role of CDO managers in selecting collateral. He said that he did not specifically recall. "I'd have a list," he said, "and there might've been a CDO manager involved, might not have been." Chris asked if there was anything noteworthy about the process of picking collateral, given that Michael Lewis's book makes it sounds like Mr. Eisman had an epiphany in January 2007 about CDO managers.

“Wing Chau was a beard,” he said. “I think all CDO managers were beards for their firms. Firms create a CDO – I think what happened was [that they] created CDOs and found it hard to sell it to investors. So they said, ‘ah, we’ll find a manager, if there’s a *manager*, it’ll be easier to sell. I think Wing Chau was the beard of Merrill Lynch. I would look at all Wing Chau deals, and I bet they were all created by Merrill Lynch. Generally, they stuffed ‘em, and he was happy to have it stuffed… [The CDO managers] are paid as part of the yield. He [Mr. Chau] was running $15 billion worth of stuff, he did not own any tranches of the deals, and he made 15 basis points to ‘manage’ the deal. That just meant he’d buy more stuff. CDO managers were not real people, they were whores,” he said.

Chris asked if he recalled any other CDO managers who supported his view of CDO managers, and Mr. Eisman said that “I didn’t do any deals with Wing Chau. It’s just my opinion on what CDO managers are all about.”

Kim asked if on or off-balance sheet leverage was of more concern. Mr. Eisman said, “on balance sheet, off balance sheet… it’s all financial institution leverage.” Kim asked if he thought any academic writing on leverage was worthwhile, and he said, “No. No academic literature is worthwhile. There’s writing that’s worthwhile that was produced in 2008. Richard Ramsden [a Goldman Sachs analyst] put out stuff on how leverage has grown over time in Europe and the US.”

Kim asked who Mr. Eisman would talk to or subpoena if he were in the FCIC’s shoes. Mr. Eisman said that he would not talk to any CEOs except for Mr. Blankfein, and that he would talk to the “people on the desks in the securitization world” and the “people who actually ran these businesses.” He said that Mr. Kronthal would be a good person to talk to, and that he would talk to people at the banks, and at Lehman specifically, who structured the securitizations. “[Lehman] not only securitized, they originated it, so they could have the full chain. And everyone wanted to imitate them – that’s why Merrill bought First Plus and Nat City in 06.”

Kim and Chris thanked Mr. Eisman for his time, Mr. Brown agreed to work with Chris to produce the documents requested in the interview, and they concluded the meeting.

A brief follow-up call was held on April 28, 2010, with the same individuals in attendance:

Chris thanked Mr. Eisman for making time for a follow up call and said that his only question was what Mr. Eisman did not tell him during the original interview in New York. Mr. Eisman said, “Well, let me start from beginning. So the last week of August 07, the salesperson that’s my contact as Goldman Sachs called me and said that they had a transaction called Abacus 18 where they, Goldman were short the transaction – it was a bespoke deal and they were short the transaction and they didn’t want to be quite as short as they were and would I like some. So I asked what is this, and he began to describe that it was all CMBS, so not residential, and it was some CMBS, triple-B+, a smattering triple-B, of a mix of CDOs, and that Goldman was short the triple A… the attachment point was I think about 40 percent. I said how much credit protection, he said 220 basis points, and I said I’ll do $30 million at 190, and he said I’ll get back to you. Twenty minutes later he called back, said $30 million at 195, and that was the end of the

conversation. About a month later the position was moving in our favor and I didn't fully understand what the thing was, so I called my salesman up and asked him to bring some people in to explain it, so he said sure. So October of the same year, two guys came to our offices and it was Jonathan Egol and David Lehman – Egol had created it, Lehman was the trader. I said to Egol, 'explain it to me again,' and he did, basically what I just told you, I said 'I understand, but why are you short?" At which point he explained a lot of – it was about half English and about half jargon, and then I asked him if I could translate, sort of 'you tell me if I'm right.' I said, 'so you put this stuff together and you went to agencies to get a rating and the biggest issue with the rating is the correlation of loss, and you presented a correlation analysis that was lower than you actually thought it was but the rating agencies were stupid, so they'd buy it anyway. So assuming your correlation analysis was correct, you took the short side, sold it to the client, and then [did the deal with me to get a mark.]' He said, 'well, I wouldn't put it in those terms exactly.'"

Chris asked if it was just the three of them at the meeting (Mr. Eisman, Mr. Egol and Mr. Lehman), and Mr. Eisman said, "three colleagues were there. I think one of my colleagues asked 'why'd you give me some of this.' They said 'we wanted another party in the transaction so if we have to mark the thing down, we're not just marking it to our book.'" Chris asked if anyone was short besides Goldman and FrontPoint. He said, "no, so someone was long, Goldman was short, and we were short. So when they go to a client and say we're marking it down, they can say well it wasn't just our mark." Chris asked if Mr. Eisman knew who the long was, and he said "never asked, never cared. Never asked on any transactions." He said, "This was a bespoke transaction – only way they take place is if someone's long and someone's short."

Chris asked if the trade was profitable, and Mr. Eisman said it was.

Chris asked if there was any issue on the mark, and Mr. Eisman said "no."

Chris asked which of Mr. Eisman's colleagues attended the meeting with Goldman, and he said "the same people as in the book – Danny Moses, etc. I do not want them involved I don't want me involved. And you don't want me as a witness on that stand, trust me."

Chris asked if FrontPoint did any deals like the Abacus-18 deal with Goldman, and Mr. Eisman said "No."

Chris said, "just to confirm, they [Goldman] goes in and are able to snow the rating agency on the correlation of loss – is that correct?" Mr. Eisman said, "yes."