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Financial Crisis Inquiry Commission Interview with Michael Burry, of Scion Capital

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The FCIC the statute that created us tells to figure out the cause of the financial crisis in a whopping 18 months and tells us to look in various areas including securitizations and derivatives and that is why we are talking to and getting documents and information from various issuers, various hedge funds, various collateral managers, and et cetera, and you are one of the folks we decided to talk to because we read about you in "The The Big Short." And we saw your appearance on 60 minutes. So thank you for coming in and what I wanted to do first that I do with everyone is can you just give me a quick background really quickly from college forward and after your attorney makes a statement.

MB (Attorney): No, I don't want to make any statement. Can we just identify everyone?

FCIC: Oh, Sure. Let's Just Go Around

I'm Sarah Knaus. I'll be taking the notes today.

Donna Norman.

Greg Hilbert

Jay Lerner

Jay Coolie

Dixie Newman.

Kim Shaffer of the Structured Products Background (inaudiable).

And, Tim Colman, Mia Havel, Jonathon Wear, And you know Dr. Michael Burry.

And Everyone here is with the FCIC.

FCIC: So with that, just give us your background and from college, educational background from college and work background.

MB: So, sure college was under-graduate at UCLA and I had a bachelor's of arts in economics I then preceded to the Vanderbilt school of medicine for an MD. I did a year of internship in internal medicine at the University of Tennessee hospital, and then I spent two years doing residency at Stanford hospital residency. After which I startedScion Capital which is (inaudible) was a hedge fund firm and I ran that until 2008.

FCIC: Um… OK we've had a chance to look at some of the documents which you've sent us and we thank you for those and what I'd like to do first is can you just walked me through the columns on this so that I know I'm actually reading it correctly? So if you could just identify with the various columns mean…

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MB: OK, so intech steel. Intech is a data provider for these mortgage pools and this is just an Intech deal number was really important is that last part that nine and seven that tells you that tranche deal it is. So these are RMBS, residential mortgage backed security. Most securities have a cusip number and so do these. Deal issue date that's the date the deal was born. Again a lot of that is self-explanatory I think. Original certificate face value: So, that relates to tranche over here. Let's look at just the first line that's easy. M9 and nine was probably the BA2 or the BBB Minus Tranche. That troll much of this deal and original certificate face value of $11,968,000.00. How much more do you need?

FCIC: That's enough for now. That Column.

MB: Current certificate balances as of the date and these are of the date January 4 2007. As of that date the current certificate balance is the same as there's been no write-downs or changes in the amount of the certificate. So signed original total combines additional exposure so, originally when we first participated… purchased protection on the nine tranche of this deal we purchased $10,000,000 worth. And as of January 4, 2007 in the next column: H we still have $10,000,000 of protection. Again, that's notional exposure, that's not actually what it's worth; notional exposure protection or value protection. The total original loan balance and that's the total number… the total amount of dollars of loans and the deal and not just the M9 tranche that would be something approximating the original certificates face value.

FCIC: Isn't that the same as the face value of the entire securitization?

MB: Not necessarily. The total current loan balance as of that date is $429,028,969.00 So, the deal overall has been paid down typically through they refinanced it so you get the payments. So that's where the deal stands. The tranche is um… the current balance is still 11,968,000.00. But the whole deal has come down some. So the um… Then there is counterparty position and so… their abbreviated, so in this column its fairly self-explanatory like the major dealers on Wall Street so now that's MS is Morgan Stanley, GS is Goldman Sachs, BARC is Barclays, ML as Merrill Lynch, B of A. I'll go through them. A lot of those same…

FCIC: Sure. So these are all CDS positions?

MB: So what these are … These represent the… This is data regarding the tranche in the deal that was shorted and you can see over here in the counterparty position where is says GS-10. Let's look at the column… or rather row five, column K. It says barc dash five, ms – five, GS – 15. Oh so our exposure there is actually 25,000,000 and it's split up five million and Barclays five million and Morgan Stanley 15,000,000 in Goldman Sachs. So those we different positions obviously so it's not that these are each one of our positions because we have… within each one of these we could have multiple positions.

FCIC: Right but for example on the first one for the first Goldman deal listed on the sheet it means that you bought $10,000,000 CDS on the M9 tranche, right?

MB: We bought a credit default swap for protection with notional value of $10,000,000. So we didn't actually paid $10,000,000.

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FCIC: I understand. And, there is nothing on the sheet that says what the premium payments were correct?

MB: Right, right.

FCIC: OK and I'd take it that when we see more than one counterparty listed that means when you originally purchased the protection you purchased it from three different counterparties?

MB: It could've been that… no not… Typically there would've been different dates from when we purchase those.

FCIC: OK, I'm sorry, what was the question again?

FCIC: For example on the one that we're talking about in row five? With Barclays five Morgan Stanley's five Goldman Sachs 15 my question was does that mean on May 5, 2005 that you bought $25,000,000 worth of protection on that tranche with the three entities? And the answer was not necessarily could've been a different case. And that was a correct re-summary of that right?

MB: Yes.

FCIC: Um, and then everything on this sheet is credit default swap position?

MB: Right. These are all credit default swaps position. These are all representative of our credit default swaps positions.

FCIC: I noticed that this sheet as of January 4, 2007 and I've had a chance to go through your most… Most of your year and investor letters and it looks like everything if not close to everything was closed out. And I know your fund doesn't (inaudible)

MB: I think they know what you're getting at. We gave you this because this is our peak exposures so, this would have everything before we sold anything. And then as of today there's nothing left.

FCIC: OK. And then, I'm assuming that this is (as I'm interpreting it) but those are just a list of the main folks that you dealt with at the various counterparties as you've purchased CDS?

MB: Roughly. Yeah those were the main ones. The main ones are on here.

FCIC: Ok Um (inaudible) And I know from looking ensure investor letters that at some point you hired some folk to work with you at Scion. And were you the one dealing with the folks in Morgan Stanley, Goldman, B of A, and Merrill Lynch or were you or your people(inaudible)

MB: Well there (inaudible) We had (inaudible) there were two functions. I dealt with the training, selection, and research but I did have back office staff that dealt with the collateral, and interpreting the daily marks and things. So it wasn't just me. I did have I think three others working on the back office functions just maintaining the portfolio and that sort of thing.

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FCIC: Ok, you didn't submit, and I don't think I want it, but can you explain to me generally the documentation that would be created to do a transaction?

MB: Well generally I would agree to a trade over the phone and then will we would be faxed a term sheet and a term sheet would summarize the trade and I'd had led by back office know what I had done. They would confirm that the term sheet reflects what we actually did. And then we would agree to that and then those term sheets would get filed and we have a lot of them. On the back office side (which I didn't get involved in) there was a daily computation of collateral and I don't know all of the different paperwork that they created and calculated and all of that so I don't know where to find it really. But, I'm sure they create spreadsheets for that sort of thing.

FCIC: But as far as documentation for you, I get the term sheet(inaudible) Is there an actual contract?

MB: before we do the trades, we agree to an instant agreement and there's an annex to that. And there's a master to the annex, so there's actually a couple of agreements. But it's basically an agreement between us and our counterparty. And it governs not just these trades, but the general swap trades of that counterparty and the derivative trades of that counterparty. It could govern a lot of things but...It's a credit agreement between us and that counterparty and we negotiate that agreement. The terms sheet that it inevitably refers back to(inaudible)

FCIC: And I apologize for not being in the business and understanding the stuff, but is the term sheet different than the annex?

MB: Yes, that's all different; I didn't mean to confuse you.

FCIC: It won't be the last time. (Laughter) OK so there's one or two master agreements between you and each counterparty?

MB: There would be one for each fund. So every fund is its own LLC and we had four funds. But essentially it's the same document.

FCIC: Standard agreement?

MB: Not very standard. We negotiated specifically to protect ourselves

FCIC: OK. We'll let me demonstrate my ignorance again is there just one annex or is there an annex for each deal?

MB:Yeah(inaudible) NO. It's not for each deal, again there's just one annex. Every time we do this the only document that's created is a term sheet.

FCIC: OK. So then for each agreement there's a master sheet, an annex, and then term sheets.

MB: Right.

FCIC: OK. I will think about whether not we wanna get those.

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FCIC: Is the term sheet just the confirmation?

MB: Yes. It's the same thing, so, sure.

FCIC: It's still a binding contract once it's finalized?

MB: Right, it's a confirm.

FCIC: Is there anybody besides Justin Green and Veronica Grinstein at Goldman that you were dealing with? Or that you recall?

MB: You know, Veronica was who I was dealing with, she was my main contact their and she was the front end sales person at Goldman. But there were numerous other people that came through the picture but they were people that I was dealing with them and continuous basis; Justin that was her assistant. Actually that's just how I perceived it, I don't know if that is actually true. And, so he was always kind of helping out with Veronica. But I can't think of anyone right now, I don't remember anybody else that was significant as those two in our dealings.

FCIC: Ok, So I have a vague recollection from the Lewis book of that there may, at least he wrote, that there may have been some issues on the collateral posting when the economy starts to go south and things start looking good for you guys. On the CDS was that the case?

MB: What time frame are you talking about?

FCIC: I think probably '07. I'm looking at your investor letters; the end of 06. In terms of the position of your CDS, it looked like 07 was the first year that started to go good for you guys.

MB: The first year that started to go good for us was February of 07. Then really start to go good for us and unfortunately for a lot of people in June and July. So we did have, and not just with Goldman but with all of our counterparties, we (I call it prosecuting our marks) we would … earn about the daily values I bought with our counterparties quite a bit over the years. And there were a few times that stood out in terms of… A few time periods that really stood out. In June, after the Bear funds failed, the middle of June was a time that really stood out. Even with our relationship it stood out.

FCIC: My recollection is that the bear funds fell in July, but is June the time frame?

MB: I think it was (inaudible) Maybe I'm not recalling it correctly. I thought it was(inaudible) I thought there was something happened in early June.

FCIC: I take it the dispute was with the counterparties was, "Hey your marks aren't low enough, you should be posting collateral for us?"

MB: The argument was actually the… We have some communication difficulties with the counterparties over that summer. Specific dates I don't recall but um, there were… In regards to our agreements, the valuation dates daily at the end of the day New York time. And per our agreements the collateral

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movements needed to occur as of the valuation date. So we required daily collateral valuation back and forth. Which, when we negotiated it, was not very common, but that was a big point for me. A daily collateral flows. And so we monitored the market mainly through the indices and as a fairly opaque market. As a for instance if our marks were being let go or we are receiving daily marks or we thought that was moving in our favor, we would attempt to be sure that we were being marked fairly so that we could collector collateral. And so that was the nature of that. Sometimes it was about where they would mark us down, our positions against us when the market would seem to be going in our favor and we would protest. There are variations on this but, you know, I would give directions to the back office sometimes to let it go. It would work out. Other times I would say don't pay collateral were going to find out what's going on. So that's what… That's kind of the nature of the dialog.

FCIC: So the communication problems I mean I don't(inaudible)

MB: Yeah it was that the… we did receive excuses from different counterparties I think a Morgan Stanley, Goldman, and B of A all had what I viewed as dog ate my homework kind of excuses. Power failure, systems failure, and stuff like that and that irked me at the time and led me to…actually consider(inaudible) So, my fear was that… The reason that I demanded daily collaterals is because I thought to these could disappear very quickly overnight and it was protection against… It was me protecting against counterparty risk. And so my antenna went way up when they started delaying or sandbagging on marks and when they started looking into the conserving cash. And so we would react to we didn't get a response but I would come to some conclusion and my letters.

FCIC: Do you recall when you first negotiated the master agreements with these various banks?

MB: It was over the period from 2003 and even up into 2005 with the various banks. I think it probably had seven or eight agreements when it was all said and done and we did them at different times but it was basically from 03 to 05.

FCIC: Was there pushback on daily posting collateral requirements and if so by which counterparties?

MB: For the trade that you seem to be most interested in, Morgan Stanley was the one that really protested the daily and this is RMBS and CDS. They really thought that we're the only fund doing this to them and it was a burden on them and that most funds would be happy and that they actually only do it every month so we're just being a big headache to them and that sort of thing. We only had so much authority there, but we attempted to push it. But I think for a while there we actually said "OK we'll lay off. We want the values every day it will take collateral every week."

In negotiating this, I was negotiating as a new…. a fairly new hedge fund. And, I was a Physician with no prior experience (seemingly), so the negotiations were difficult and there was tremendous pushback as I attempted to get terms similar to what they would offer their better clients. So..

FCIC: And just so I understand the collateral posting terms are in the master agreement?

FCIC: But it was the daily that was unusual? Because even with their preferred clients they wouldn't usually do a daily…?

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MB: We were told that the daily was unusual. Another one was with the Deutsche bank, but that was right at the beginning we actually… Deutsche bank fired us a client right in 05 because we were too aggressive in prosecuting our marks. So, we retained the positions with Deutsche bank we didn't do any trades with them at their request because the daily valuation and daily collateral was just too much of a burden for them and they said as much.

FCIC: Were there are other things that you wanted to say about the master agreement?

MB: So, there's something in this agreement called additional termination events or ATE's. One of those is the NAV. So this is the protection, their protection, against us losing assets and becoming a less creditworthy counterparty. Those were typically pretty narrow. You lose 10% and you're pretty much done. There was a monthly, quarterly, and annually NAV declines that could trigger these additional termination events that would allow them to tear up the contracts.

So we negotiated and I presented evidence that they were a volatile fund that I fully expected the volatile flows and we got much wider NAV triggers. The other thing that we negotiated on that was significant was the minimum transfer amount and threshold amounts. The idea being that … For instance Goldman originally said if you owe us 100,000, you need to send it. But we don't need to send you anything unless we owe you 25,000,000.

FCIC:Was at the numbers for the 25?

MB:I don't know about the numbers but it was small and the 25 I know. That was an extreme example but that's generally how banks approached us. But I wanted us to be equal or close to equal. If it was 300 are 500 that'd be OK, so we negotiated until we got close to equal. And I wouldn't enter into it unless they got close to equal. So, those were the two in addition to daily those were the two that we negotiated on pretty hard. For the spreads, I think it was 15, 30 and 40. 15 in a month, 30 in a quarter, and 40 in a year. These are percentages. It wasn't just performance; you could be performing fine but if you lost half your capital through withdrawals… It wasn't really a measure on performance as much as it was a measure on how much capital you had to back up this trade. So, and the other thing that was an issue that we couldn't change was the valuation agent. So the valuation agent was set as basically the dealer. What it essentially says is the dealer is the valuation agent and whatever the dealer says is the value is the value. That really didn't come into the negotiations so we accepted that for our fund accounting as well.

FCIC: Was that not part of the negotiation because the bank said, "Look this is it take it or leave a term," or did you try to change it?

MB:it was not part of the negotiation, and I think I was aware that time there was no third party in this market. This is an opaque, nontransparent, the liquid market. Possibly some of these things that I bought would never trade againuntil I sold them. So there's no good third party. You need to rely on something. I could rely on the model that I could create but I wasn't going to do that. So I relied on the dealer's and the valuation as just about everyone does.

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FCIC: and when you say the dealer to that mean the actual counterparty?

MB:Yes.

FCIC: So each counterparty for each CDS was the actual valuation?

MB:Yes.

FCIC: So was there a mechanism if there was some sort of dispute in those marks?

MB:There was. Yes.

FCIC: Well what was it?

MB:It was in our terms sheet. It wasn't specifically RMBS or CDS agreement; it was a general dispute agreement that was required to go out to four neutral parties to get evaluation on the security. And then if you can't find four, what they say goes and that's the resolution.

FCIC: If you can't find four, what they say ….they being the dealer?

MB:Yes.

FCIC: Let me just interject with something because I think this is a very complicated dispute resolution provision. When you say four neutral parties, is the term reference market makers?

MB:Right.

FCIC: And that means, generally speaking…?

MB:I wasn't being very clear there are so… You had to find for essentially reference market makers or established market makers to provide quotes and obviously when it comes to RMBS there is no such thing. So, the dispute resolution was pretty much you set the value, we protest, and you set the value and that's pretty much how it works.

FCIC: So these marks then, I think you probably already answered my question, but from other folks and we heard about you do the dealer pole and then, here's our bid and then will actually do the trade at that price. Maybe that then didn't make a difference given the illiquidity… where you were buying the CDS on, but was that part of that deal in your contract?

FCIC: Would you then discussing evaluation issues get into different assumptions arguing about delinquency, recovery, payments, any of that? Would you be arguing those numbers or were you just like come on 90 or 70 or 20…?

MB:Absolutely, you have to break it down into the components. The discount rate has been low for a while. The one that is problematic for me was the CPR or the prepayment speak. Which itself was a calculation but, the idea that…. So… Should explain that or… While you know it so?

FCIC: I actually didn't do mortgages…

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MB:Well …the value that…what goes into the value of the contract that we've entered into really… All have to explain it. A corporate contract … what goes into a corporate contract is… you enter into a five year contract so say you entered a five year contract you know what you paid, you know what the premium, is you know how long it is, you know what the interest rates can be … you configured out. So you have the market and you can figure out what it should be. So with the RMBS there is obviously prepayment. Nobody knows what the term is. The stated term is 30 years, it will never get there. So something called a spread duration call were basically the duration of this contract is going to be determined to a great extent of the prepayment speed which is commonly called the CPR so the value changes dramatically if you have say a 45 CPR and the spread duration has to be 2.1 years or something like that. But if you move that to 85 the CPR rate than the duration crashes down. So that obviously affects the value; when the duration falls the net present value falls. A so we would argue on this quite a bit as were practiced your calls. And again there's nothing we could do if they moved it to someplace I didn't think was appropriate.

FCIC: Would they argue that, "Well the implied CPR from ABX is 'this'," or were you arguing security by security for different CPRs?

MB:well it was tough because I was … Will I think it was the first to trade these so my mortgage portfolios were maturing at a different speed than the regular markets. So with the indices there are these things called recovery locks, and they are actually markets and recoveries and things like that. And there's actually a market for CPR and there's markets for all of the stuff. So the problem was that, the our contracts were earlier than what most people saw with the market. For instance the ABX 06-1… The ABX indices the first indices were actually 06- indices. And that was already nine months after our first trade essentially. So I didn't think that going to the market was really the way to evaluate this. You know, come '07, this was already a 24 months. So the CPR rate for that month…if you just look at that month, the 24th month or the 23rd or 24th month on a typical arm with a two year teaser rate, that is going to shoot up in those couple months. So in any event the CPR rate on our underlying reference securities were just different than the market generally showed. So you had to argue I know what it says but were on the 24th month in a 25th month that goes… So those were kind of the valuation arguments that I had and I would handle this if I understood it better.

FCIC: There's no reinvestment in RMBS correct unlike a CDO or…?

MB:I didn't deal in CDO so I don't know

FCIC: Were your securities that you shorted… Were the trusts' of the securities able to reinvest in other mortgage is if they were to experience a lot of the prepayments or were they just lying down?

MB:Essentially no. For reasons of fraud if they can replace mortgages at the beginning in the completion of six months, but the trustee your servicer… but not for prepayments. They had something called a step down mechanism for handling that to keep the reinvestment risk to a minimum for the seniors and for the senior tranches in the pool. Some anyone that's pretty interesting…

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FCIC: So when you're having these disputes with whiff of the various counterparties up let me ask were there certain counterparties where there were more disputes with than others?

MB:On the baseline we fought with them all. I think that we actually found Morgan Stanley to be the most difficult to deal with. Obviously we ended up giving them weekly evaluations so a… Goldman and B of A both … There's really different reasons. Goldman and B of A … Well Morgan Stanley would often stalemate our portfolio. They wouldn't change our marks for a long periods of time and that was hugely frustrating for us especially once we got into later of '07. Then we started to wonder about their security as an entire company.

FCIC: I thought that started to…

MB:Well, what I'm talking about is this problem of stalemating… We gave it to them every week I think somewhere in the summer of 07 but that stalemating was a problem for them for… Throughout the trade with their trades with them. And again even if you go five days before you know we wanted the valuations every day we want to transfer collateral. It gets complicated and how they move it every day they tend to move it with the indices every day and if they don't move it with the Indus see in our favor and the next day they moved when the indices are not in our favor and they keep doing that the eventual effect is harmful to us so. We were interested in getting those valuation confirmations every single day even if we were only transferring collateral every week. Then there was Goldman a significant… I took it as… Also understand that when I'm dealing with the street I tend to think from a lay perspective that they're all crooks. And I believe the worst when I would see evidence in my portfolio that maybe they were playing games. So I thought that B of A at the end of '06, I thought B of A and Goldman were playing games with their year-end numbers and we could see that in our book. And that's all I can know at that time. And since then things we found out about that period … But at the time I thought what's going on here for golden because that's all I knew. The spreads got ratcheted down significantly and then they got held steady for… And then there was the other period with Goldman, which was a pretty frustrating period in June of '07. But it happened where if B of A that summer and it happen with Morgan Stanley that summer so I'd say was those three. You'll see that those three are our main counterparties too.

FCIC: And when you say that the June 07 time period was frustrating, why wasn't frustrating?

MB:Well the market was starting to move and was represented by the indices and the sentiment and the commentary in the market was that the market was moving and should have been moving in our favor. It seemed that there was a hitch in the marking process and valuating process during that time. So…

FCIC: Did you ever have any discussions with those counterparties at that time about how they were marking their marks. Or those counterparties … were they in short position?

MB:No.

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FCIC: Um, when you said the information in your books in the end of '06 time frame indicated to you that maybe Goldman was playing games to make their numbers look better… What you mean by that?

MB: Just that … I can remember the date but it was 45 days before Christmas and there was (I think it was the 21st), we saw our marks of Goldman up take a fall which hurts us and benefits the party and the other side. And it seemed out… really way out of line with whatever was happening in the market. And then after that they just went silent until and through the year end. So I tended to believe that a lot of companies play games to help their year-end some things like that so that's what I thought was happening.

FCIC: And I thought I heard you say too that later on you found out that the additional information about Goldman…

MB:Well it's just common … It's just what's been in the news out know anything specifically…

FCIC: And when you say what spend the news you mean…the decision that they decided to go short tour of the end of 2006?

MB:That's not my understanding. My understanding from the news is that they decided to wrap back wrist in that area. And so now I'm might interpret it that they decided to ratchet by knocking down my marks and holding it steady for the rest of the year. But that's all speculation on my part and just from what I see, read, and hear about in books and things like that.

FCIC:Did you have any discussions with Grinstein or Green in Dec. '06 time period about…? About your concerns?

MB:No. I don't remember very well but I do remember that there was discussion amongst us at the end of the year that it seemed like Goldman taken the last week off… maybe vacation?

FCIC:OK did you know what the time that Goldman's fiscal year actually ended in November?

MB:Yeah I found out later (laughter) …that what I'm saying is that there's things I know now that I didn't.

FCIC:So they were later?

MB:I think that yeah ,What I mean to say is that my original logic for there was probably not right.

FCIC:You know one of the things that we are doing is investigating that type of potential conduct. Are their documents that you guys have that would explain what you're talking about here? Things that say yeah well this is the sheet that I'm talking about. Things that made us question was going on at Goldman in the last couple of weeks and 2006?

MB:IS there a document or documents?

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FCIC:Whether it's a financial report of what going on the market versus the marks or email traffic between you and your staff, or email traffic between you and Goldman, you know I mean anything like that that would help us to get a better idea of… Since now your recollection is more than a couple of years away.

MB:I'm sorry I receive most of my information from my back office. So when it comes to the marks I would just get this information from them and again and not super familiar with what documents were produced other than… I mean I was just told what was happening.

FCIC:Generally, communications with the counterparties: phone, e-mail, or other?

MB: Sometimes email, but a lot of phone conversations. A lot of it was time sensitive so get on the phone…

FCIC: Sure, and in terms of e-mail communication, is that you or was it the back office or was it both?

MB: They would have been corresponding, probably not with these people but with Goldman's back office I would imagine. Because they would get their marks via e-mail.

FCIC: So are you saying here's what the marks are?

MB: Right.

FCIC: And would those emails…

MB: I didn't receive those emails but somebody did.

FCIC: People in the back office of Scion got the daily mark emails and those I understand it take it you've seen them before right?

MB: Yeah, Not very often though. I mean if I can recognize it …but no. I probably have seen it before.

FCIC: What I'm getting at is could you generally just explain what was in that document? I'm assuming it wasn't just a number with securities right?

MB: What was in the document was on number, literally. It was this position and this many dollars. So, some kid and spread but mostly it was in dollars and that was with the position was. So you could compare it to the prior collateral position and decide which way to go.

FCIC: With no explanation of methodology?

MB: No not in the daily marks.

FCIC: Does that mean that there was an explanation of methodology in a periodic basis?

MB: This is what I was talking about earlier when I would get on the phone and complain. And I would get responsive onto what was happening.

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FCIC: Can you just sort of backup? And I know I've read your investor letters, but generally explain to us which are thinking is and when you first decided that there was problems and housing market and when you first looked into these positions?

FCIC: So is the question when or what made him decide?

FCIC: Both. When and Why.

MB: Let's see… I was… The way that I got involved in housing and all was by… I was a stock picker and I was pretty much a long-oriented stock picker. So, I started looking at home builders which were all in the press and a lot of people were saying that they were undervalued securities. So I looked at them and I decided that I didn't think they were terribly attractive because they were benefiting tremendously from the increase in land values on their inventory and that this was contributing to a great extent on their returns. And it led me to… So I didn't think too much of the home builders and I let them go, but I wasn really thinking that housing was going to collapse, I just moved on. And in looking at them I started thinking about how housing was financed. This was 2002-ish and I started looking at the mortgage insurers and PMI in particular. Then I compared it to MGIC which is another mortgage insurer and I read their filings. I noted that they were getting involved in so-called insuring negotiation transactions or bulk transactions. So what the time I didn't even know what they were so I said OK what are these and I think I like to study insurance so I did notice that their strength was there typically there line of business to go into the auction basically insured by an auction process that doesn't guarantee them any unusual knowledge that might advantage them in their underwriting. So, I moved to looking at the mortgage pools a star and understand how they work. This was by spring of '03. What it did was it lead me to start getting involved in the credit default swap markets so that's another story but in studying and understanding RMBS, it was an information that I used too much other than to just monitor the market for a while and I actually instead moved to purchasing some credit default protection on some financial companies and that was a result of something else. So 2003 was when I first started and critiqued derivatives and I learned a lot about the credit derivatives market over the year or two leading up to 2005. That's when we did all these and that sort of thing. I was particularly interested in the history of the housing or I should say the history of the derivatives market and how it developed and so that's also another part.

Against the backdrop of what I thought was a very easy regulatory and monetary climate, a team to view the stress free yield and what people would do for yield as irresponsible. And I understand it but it's still irresponsible, and actually thought that the government was acting pretty badly in the late nineties. I think that going back to 97 and 98, I thought that the governor was acting pretty irresponsibly with regards to moral hazard and increasing the risk of giant bubbles in our system. And after the tech crash, 911, WorldCom, the interest rates obviously fell and there was other mechanisms in place as well to put credit into the system. And I noticed that it was affecting the housing markets through the types of mortgages that were being introduced. And so I termed that extension credit by instrument because once rates had fallen by certain level, interest rates for our forty year lows weren't going any lower. How do you stimulate demand? And one way is to create different Mortgage Products that essentially allow home prices to rise? So on the back of this easy credit there's also the whole issue of how

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mortgages are being originated. Typically through a mortgage broker into an originator in an originate and sell model mortgage originator that would then sell off the mortgages to Wall Street increasingly so. I saw all kinds of problems with agency risk, moral hazard, and adverse selection throughout that entire process. And when you pile all these things up, what I came to worry and have significant worries about the housing market in '03 and that's when I turned to investors as a basis for concern. I didn't think that or warn that these were multi decade cycles or that we shouldn't jump to any conclusions. By 2003 I saw the introduction of interest only mortgages and I watched those with interest as they migrated down the credit spectrum and into the subprime market. And when they had migrated down the credit spectrum about as far as they could go down … other products were created. Notably, in my view, the option arm for negatively amortizing a mortgage; which I viewed as the most toxic mortgage that could ever be imagined. And, I thought at that point since home prices had been rising at a rapid rate, essentially on the back of easy credit with no accompanying … virtually no accompanying rise in our wages or incomes… that I came to a judgment in 2007 (2 years hence so it would be a final kind of judgment on housing). Those people seeking out those two year arms seek to go refinance. So I was watching these mortgage pools, and it came to a point where I paired my understanding of the derivatives markets to what I saw in the mortgage pools. I called up Deutsche Bank and asked if … well actually I thought that they would start trading RMBS and CDS fairly soon. Based on the history of the development … because I had derivatives. There's CDS on corporates and it just played out over the 3 or 4 years. After the whole thing with one of your main members where it got shotted down and the whole commodities modernization act and all of that … You had this play out where at that point you're dealing with these off contracts. But once the CDS got standardized, it took off to a point and then synthetic CDS's came around. And then it reallytook off… And so it made sense that this would happen in asset backed securities to me because you couldn't naturally hedge this. You had a market that was bubbling over and people were going to realize this soon. And you couldn't hedge these positions. If you had a big mortgage book and you were a big mortgage fund or a bank, then how are you going to hedge these positions? So as the original corporate CDS was created to hedge loans at banks, I figured the mortgages books are so important to the economy and to every institution so, it makes sense; the CDS makes sense. So they weren't ready at that time.

FCIC: Excuse me, I just want to understand then sequentially and I apologize for the interruption. But, you were expecting … you were at the forefront of the shorts but you were expecting that there would be demand for going shorts by buying dealers? Or byinvestors and mortgages?By Whom?

MB: By anybody looking to hedge. So, hedge funds with DAR issues. Banks, mortgages, and certainly some of the banks with mortgages …

FCIC: So anyone with mortgages?

MB: Yes anyone with mortgages but that was an awful lot at the time. So I thought that there would be demand for this so that's when I called Deutsche, but they weren't ready yet. They didn't have it available. So, I told them to call me when they did.

FCIC: Is this like mid – '05?

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MB: March of '05.

FCIC: Why Deutsche Bank?

MB:Deutsche Bank was the one who.. It's a good question since we weren't trading with Deutsche Bank. But, Deutsche Bank, I was actually talking with Angela, my sales person, and she agreed to put me in touch with their trader. It was some guy named "Rocky" that she knew, and I only talked with him once; that one time. But he's on that sheet. But this guy Rocky was a senior trader at Deutsche bank, so I always had a good relationship with Angela, even though it fell apart. So I asked her, "Hey Angela, what do you know about this? And have you heard about it…?" "No, talk with Rocky." And when I was talking with Rocky, I heard, "Oh they're doing it one offer, but nothing is standardized." He can do something for me, you know maybe we can get something together and maybe we can do something … but it's not going to be a standardized term sheet or a standardized contract that's really tradable amongst all counterparties. And I didn't want that. I wanted something that was freely tradable, there were no baited amongst counterparties. So, we couldn't do anything at that time so I just went on with my other stuff.

FCIC: But may I ask, you said … I noticed that Deutsche Bank isn't a counterparty to any of the trades that are on the Scion of ABS portfolio spreadsheet here, is that …?

MB: Which Bank? Deutsche Bank?

FCIC: Deutsche Bank, right.

MB: Right.

FCIC: So you didn't do any of the mortgage related … CDS trades with Deutsche Bank. With what you were talking about earlier were different trades with Deutsche Bank where they fired you as a client.

MB: Yeah, so those were corporate CDS trades. But, you're bringing up a good point. So, this does not have our Deutsche Bank trades on it; because, I sold them to Gregg Lipmannin late '05.

FCIC: So this only has … the listing that we are talking about only has trades that existed as of January 4th 2007? Those that were still on the books?

MB: Well … that is correct but there's only one set of trades that are not on here. There's 60 million notional that we did with Deutsche Bank that was off our books by late '05. So I'm sorry about that, I had actually forgotten about that.

FCIC: Everything else is on here?

MB: Yes.

FCIC: OK, So we've seen some (or I have at least seen) your investor letters and a sort of a supplement explaining securitizations and subprime. And we are interested in talking to folks in their views that

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saw the market before others… Is there other writings that you have in terms of showing your views on the market in the early 2000's other than what we've already seen that you've produced?

MB: No.

FCIC: Your investor letters were quarterly?

MB: Yes.

FCIC: Um … as you're coming up with your views throughout the two thousand three, four, five, six, seven – timeframe, are you talking to other investors that are taking positions like yours? I don't recall that at least from Lewis' book at least. I recall people in that book that are taking short but I don't recall them … I don't recall anything in that book where you talk with other folks that have the same views and they're making the same trades because of discussions with you or otherwise.

MB: Right, No.

FCIC: Excuse me. Are you reading street research about mortgages and disagreeing with it all? Or finding any of it interesting to you?

MB: No.

FCIC: I take it that you've read The Big Short(laughter).

MB: Yeah … Yes.

FCIC: Well we're not going to go through it but just generally, anything in there that struck you as wrong in terms of how it describes you in that book?

MB:You know … I'll preface this by saying in just reviewing it lately I have read it once and I don't remember it very well. But I was reading some just today and I was going, "wow I don't remember reading that…" So there might be a few things. But, I think that, ugh, I work with Michael pretty closely as making sure that he had the story. What he put out there seemed to be pretty close to what actually happened. My wife liked it (laughter all) so it's one of those things that struck people as true. People that knew me said that seems right and I certainly felt that it was a pretty accurate portrayal.

FCIC: Any discussions then with any of the other folks in the book?

MB: No.

FCIC: Either before the book came out? And I mean when I say any of the other folk like whether it's Mr. Eisman, whether it's any of the three from Cornwall… ?

MB: I think that I've only spoken with … I didn't hear of any of these people before. I never heard of any of them before except for GreggLipmann . So Greg Lipmann I spoke with in November '05. And then there's Eisman, where I just had a brief "how ya doing?" call after booking. Nothing subsequent.

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FCIC: But when you did the trades with Deutsche Bank to begin with, you didn't go through Lipmann…?

MB: No.

FCIC: Well then, did he call you and say, "Can I buy back these positions for Deutsche Bank?" How did that happen? Did you contact…? I mean how did you guys…get in touch with each other?

MB:OK, Lipman actually reached out to me at the time as if we had interacted before. I didn't remember interacting before. And, he was interested in buying back the positions with Deutsche Bank. And he was interested in buying … and wanting me to present the rest of my portfolio to pick through. You know, then I just said no, and that's pretty much the extent of it.

FCIC: How did he know about your positions to begin with? Did he tell you?

MB: You know I have no idea how he knew that I had positions. I think that we had about a billion short at that time, and I had no idea how he knew at that point.

FCIC: Did he have an idea (inaudible)?

MB: I don't recall. But I had no idea how he knew because these letters didn't go to the trading side or counterparties. They just went to the credit side, and they weren't supposed to be shared. But, I assumed he had gotten my letters or had heard about me marketing, or something like that. Speaking of, you asked earlier about Deutsche Bank and why would they deal with me; they didn't cut me off until after we did those RMBS trades. So, yeah it was June 2005 was when they cut us off, after May 19th 2005.

FCIC: So your 2007 annual letter says that you've gone from like radically reduced your position from $6.7 billion in late 2006 to $800 million. Earlier I asked you and you said there's nothing there now. When were all the positions closed out by? Do you recall?

MB: The RMBS - CDS stuff, by (I believe) the first quarter of '08… probably by March of '08.

FCIC: So do you recall if you had any CDS with Goldman in the third quarter of '08 when AIG goes down?

MB:RMBS - CDS?

FCIC: Anything.

MB: I don't know if we had any corporate or sovereign CDS. We may have … but it would have been very small and it would have been residual type positions. RMBS – CDS we wouldn't have had. But to be clear we sold off all … we ended up trading out of all of our positions except for two. And, we actually held them just for spite. Just to show that they go to zero. So they went to zero when… It's funny about the way the contracts are written. It's in the book as, what happens if the written back up and we're no longer around but nobody cares.

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FCIC: Right, right, right.

FCIC: So obviously we're looking up how, different factors might have contributed to the financial crisis. Because of your involvement I guess I am curious as to what your net verdict is on the derivatives market. You said deregulation of the CFMA was a factor. How did that contribute to the mortgage bubble?

MB:Well … I think the mortgage bubble was not a function of derivatives until the last year or so, in my view. I think that derivatives were a huge problem that were run by a bunch of 30 year olds, and there was very little gray hair in the whole process. You know, maybe later on. I think that if the market was properly regulated at the beginning, and that act hadn't been passed … I don't know if the CFTC is the one to do it, but if the market was properly regulated it never would have grown like it did. Unless it was some political appointee running it (which it would have been). But I really believe that we were better off without the derivatives.

FCIC: Are we talking about credit derivatives?

MB: Credit derivatives. Yes. I think that the standardized market for credit derivatives, is not necessary. I think that for parties that want to hedge books, they can do the one offs. But, I think when you make it standardized, it's a slippery slope in general, and people went wild with it. I don't know how much you've gotten into synthetic CDO score where all the structured products that became options on this stuff. I mean it got insane. It was whatever the wizards could dream up and people honestly though Wall Street is smarter than Washington. So, my view is that you shouldn't allow that which you can't regulate or understand. So, I thought it was a huge mistake to see that market for whatever Wall Street just wanted to do with it.

FCIC: But you said one offs would be ok. So still the customized…?

MB:Well I think there's a need … there's going to be a need for. But you know those custom one offs were super liquid between counterparties for hedging purposes. There is an argument to be made that you shouldn't allow what I did. I mean, not that I think what I did is wrong, but it's … you shouldn't allow the naked … and not just the shorting but actually just the accepting of risk derivatively; which is really a big problem. Because, you know, when I did the shorts I was mostly putting on the position of mostly hedgers that were really doing it. But there were people on the other side who were eating up just everything and they were looking for whatever and this was an easy way to create something out of nothing. And so Wall Street did. I think it's a catastrophe, and I think it was preventable. There were rules that I wrote about in my letters. And while I don't remember them very well right now, it was in 90 … as early as '97 and '98 basically regarding the capital money for derivatives that were basically allowed for accounting for derivatives in a more beneficial way for institutions to use them. So, I … you look at the whole bastille thing and the modernization act.

FCIC: Are you talking about the capital treatment?

MB: Mm-hmm. (yes)

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FCIC: The one that allows for more leverage because banks didn't have to hold capital that …

MB: Yes; exactly. In '97 and '98. I put that in my letters in my first instinct when I first read about that. And when I started thinking about the market I read about that and thought, "Ok well this is not going to be good."

FCIC: So they can't hold equities but they were allowed to hold derivatives? Or, um, equity derivatives?

MB: Right. So you don't have the same capital requirements on derivatives as you do on any other type of investment that you may make. And there's no reason for that. I mean, you're accepting all of the same risk; actually even more so it turns out. So, but, I have a lot of views on all this but it's … I think it was a mistake to … then there were some FASBE rules in late 2004 regarding insurance companies and allowing them too … I can't remember them very well but I put them in the end of my 2004 letter (I think) or my last 2003 letter. But, it seemed like the system wanted this to continue. And obviously it was a huge boom for our society for the bubble to go on like it did and like it was going on, but, I think there was … it was part of the system to try and keep it going. I mean, I saw that and from '97 to '98 on I just felt that there was this government which was not involved. They wanted housing price appreciation, they wanted loans to go to people that don't deserve them, and they're doing that while you then have all of these originate and sell lenders showing up who don't originate any loans; they just sell them! So they have no concern … they get their revenue on the gain of the sale of these mortgages. And that introduces all kinds of risk into the system, and they're usually going through mortgage brokers, just to throw some more risk on them. So we have this agency problem, and the moral hazard involved there. So basically lenders were not going to check excess credit risk at the door. People aren't going to do it … the borrowers themselves? I mean, it's an open question were the borrowers any less greedy than the people on Wall Street. I mean, everybody wanted to better their lives and everyone wanted the bigger house that they couldn't afford … but it's just all through the system. There was no checks; no balances. So once I ascertained that government was absent, and the banks weren't concerned about credit risk, and I knew that people weren't going to do anything about it… then it's just wait and watch and see what they create and what they do that could blow us all up.

FCIC: Did you see the Cash CDO as a significant element when it started to be based on ABS and taking up all of the middle Tranches of ABS…?

MB:I think that's a problem, but it wouldn't have come like this. I think it is a problem though, but it's a matter of degree. In my view, banks should not … you should not allow an originate and sell type bank. Banks should be required to hold some of the loans that they make in any category of loan. So it's not just you need to hold 70% of all the loans because then they'll sell of all of the bad ones. I mean, any type of loan that they make, they need to hold a certain percentage of those on their books, and they need to take that risk. If you just make it a flow through entity, where they get fees off the pass through… That was obviously a bad idea. At least I thought so.

FCIC: But when you have the derivative products, can't they just hedge whatever they hold? And then end up in the same place?

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MB: They could but I think that that's just a much easier process to regulate and to keep hold of. They wouldn't be nearly the size that … because then you have real products behind mortgages and it's a different … you know with the derivatives and the way that they were going, everyone was taking risks on securities and there was no assets so… I am all for, and personally much more than Mind or Faulk are saying. But… just the idea that banking should be the calmest and most boring industry. It's how we regulate our money supply. It's how we manage our monetary policy. The banks need to be there to do the jobs that we need them to do.

FCIC: And the way that you described the investor agreement, it seems very biased in the favor of the dealer, and against the investor.

MB: Well that's the whole issue of, do we really want our dealers to have proprietary trading desks and … I think that we should have M and A banks, and we should have banks, and then we should have brokers. And they should all be separate and they should all do those basic activities. And, I think that we're … I think in Goldman, there were people who were working on both sides. What I mean is that there were people in Goldman who disagreed with going long on the market and those people disagree with people going short. And the Goldman outfit blew up! I mean, you know, it got really hurt by all of this. And those were some of the best and brightest. They created this to keep their best and brightest. Then there was other people in Goldman who were the best and brightest that said, "Yeah I don't agree with you." But it was just within the thing. So, it's all … why should Goldman even be doing this? If you want to run a hedge fund, then start a hedge fund. Go and do that or do something else. So, I certainly thought throughout this whole process that the position of the firm was influencing our marks to some degree because I knew that our marks, whatever our marks were, were how they were marking their books. So, if they're holding them low and maybe they've got a firm position as a firm that reflects that they like them to be low; and vice versa. And they could keep going forever…

FCIC: Wouldn't they want you to? (Laughter)

FCIC: Just to clarify if I may; all of your trades related to mortgages were single named?

MB: Yes.

FCIC: And did you know either when you entered into them or at a later point, how many if any became part of the synthetics CDOs or hybrid CDOs?

MB:Yes. So, um…. Yes I knew that they were becoming part of synthetic CDOs.

FCIC: So, you had some understanding that that's why they were looking to you to take the short position?

MB: Yes. That was how risk was bought in the derivatives market. I assumed that these things went into synthetic CDOs unless Goldman or somebody was willing to just take it on, that whole risk on themselves, it was going into a CDS – CDO.

FCIC: And did you have contact in any way with any CDO managers?

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MB: No, no CDO managers.

FCIC: And did you have thoughts at the time (given your views) why does anyone continue to invest in synthetic CDOs?

MB: I think it's ridiculous. I mean you can still go out and do every single thing. I think it's ridiculous and have strong views on what we're still able to do now.

FCIC: Were you ever aware that, perhaps, the ultimate counterparty on any of your trades was AIG?

MB:I'm sorry … Say that again?

FCIC: That if a dealer has given you protection that perhaps they had gone to AIG and that AIG might have been their counterparty? I mean, if you don't know that's fine but …

MB: Yeah it would be speculation on my part.

FCIC: But you never had any conversations that said, "This is where we get our …?"

MB: No, no. This is where we get … yeah, no. Nothing like that.The idea that AIG wants to sell out protection; nothing like that.

FCIC: Just to ask a similar question just if I may for clarity… So you had a general sense that your purchase of protection would be part of synthetic CDOs, but you didn't really know at all who the investors in the CDOs or the investors in the AAA markets or the mono lines … or did you look at the mono lines or pay attention that they might be involved?

MB: Oh sure. So I had the general idea that AAA credits would be buying this protection. So, I know that even before I put on this trade, I had a problem with AIG, and I would short AIG because I knew… before my first RMBS trade I already had concluded that specifically AIG and the other AAA mono lines don't have to post collateral like the rest of us. And, should they run into trouble … basically what happened was that they needed to post collateral. And, that would be catastrophic, because that would be built up and they couldn't possibly have the cash on hand, given the way they run their businesses. I had a big problem with the AAA mono lines as well. I just didn't consider these to be AAA.

FCIC: Did you have a short position in those too?

MB:Yes.

FCIC: When did you put on your short for AIG?

MB: I think it was in that timeframe: the spring of '05.

FCIC: Did you know separately that maybe they were involved in your trades? That they were writing this protection?

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MB: I had actually suspected that they were writing this protection and that all these AAA might be writing it on themselves.

FCIC: How would they do that?

MB: You know just with writing protection on themselves one way or another.

FCIC: I've heard that a couple times but I just don't fully understand how they could have done that and how I might figure out if they've done that. So maybe you could explain that?

MB:Well, it seems kind of strange, but once you filter it through a few different securities … well filter it through structures on the derivatives market. You could potentially get to where the ultimate buyer doesn't think … or know who they are facing or what they are doing.

FCIC: So they could have been doing it, and not knowing it as opposed to doing it and knowing it?

MB: That the buyers of the risk … well … the ones that are ultimately taking the other side of the trade don't know that AIG is there.

FCIC: Is that because AIG corporate credit would have been in some sort of CDO?

MB: Well it was. I mean there were corporate synthetic CDOs. … There were synthetic CDOs in the corporate CDO market. Huge, huge.

FCIC: So for example, if AIG (which we know it did) had a corporate credit business in addition to its asset back securities CDO credit business, if it had pools of corporate credit in which it was riding the senior protection of the senior most tranche, then presumably those pools could have included AIG?

MB: I think that you are getting beyond me a little bit …

FCIC: But is that what you were thinking of? And in terms of them writing protection on themselves? Or were you using a different type of example to do that?

MB:I think that they had a different idea to write stuff as a general rule for protection on themselves. I just wondered if maybe when AIG goes through the accounting scandal, when spreads get really high, then they might jump in and take advantage of that, someway in the derivatives market. Um, but it's all speculation on my part. With AIG I was just looking with the fact that they are a AAA, they're busy, they're impossible to analyze, but I shorted their credit but it was just on the fact about collateral and just what I knew about AAA counterparties and collateral and what I thought was coming down the road; but not with AIG, just in general.

FCIC: You talked about the particular terms of the master agreement which you negotiated for your own confirmations and master agreements. Did you specifically negotiate any terms related to the collateral trigger points? Not that it would change hands daily but what …?

MB: Right, so the threshold amount or minimum transfer amount? Or the credit … you don't generally get to negotiate what the credit will be. I was very … the credit events in the corporate CDS market went

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through a number of generations, so you follow those. There's the "modifieds," the modified structures. And so I didn't get to negotiate those too much. I would say that it was a big issue though, obviously with Argentina and JPMorgan some years before what the credit event actually was. A lot of those CDS players didn't actually get paid. And that was on my mind.

FCIC: So you said that most CDS's on the other side of the trade was synthetics; so that's where the demand was on the selling of protection for the most part? You were talking about the corporate CDS market but also the ABS CDO market I guess?

MB: OK, an ABS CDO? A synthetic ABS CDO? Can you say that again?

FCIC: You said that you had a suspicion that the CDS you were taking, that the other side would end up in a CDO.

MB: Or it would be held on the books of the prop desk or whatever.

FCIC: So I was just asking about the corporate CDS that you were writing, the 405 as well as the CDS, RMBS, the CDO you were writing …

MB:Well, the corporate CDS… when I got involved with corporate CDS, the synthetic CDO machine was really up and running and roaring ahead. You pretty much just assumed it was a lot of going into synthetic CDOs and corporate space. That wasn't true with RMBS CDS.

FCIC: Oh that wasn't true with RMBS? OK.

MB: RMBS CDS when I first started, there was no ABS synthetic CDO going at all. Obviously Goldman started up Abacus. And, Goldman was really aggressive in that market.

FCIC: So at some point over the period when you were taking CDS positions in RMBS, those might have ended up as well in the synthetic CDOs but not at first.

MB: Yeah, I mean … my understanding at the time was (well my assumption), was that it would end up in synthetic CDOs eventually. And eventually these would really get going in an asset backed market. But at the time, I knew the market wasn't really going very strongly. It didn't start up until 6 months after I started. It didn't really get going until basically late '05. I mean there was a couple Abacus deals in those last 6 months, but … My understanding was that, at the time, Goldman had to warehouse some of that risk, because you didn't sell a synthetic CDO every week. You had to take that risk on over the period of a month or two. And it had to be structured somehow then you'd sell it. There's not much more, I mean it's not really that big of a market. In fact B of A and all these others weren't in it.

FCIC: And just technically that's wasn't an innovation, they would just countertrade so that they would make a deal with you and then just turn around and do a similar trade with the CDO…

MB: I don't know exactly how they did it. I wasn't involved on that end at all.

FCIC: Ok, so did anybody ever know then or?

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MB: No.

FCIC: OK

FCIC: And so you chose not to participate in any of the indices. Like you could have gone short different versions of the AVX?

MB: Right. That's correct. I chose not to involve myself with indices. So, you know … you probably want to know why? (Laughter)

FCIC: Yes. And then, in addition I would like your policy view of the utility of the existence of those indices.

MB: OK. So my recollection was the AVX indices of the credits that were put in there were not great credits. And certainly when everything went bad they weren't bad too, but they weren't the worst credits. The other thing was that they were often split rated, meaning that Moody's and S&P disagreed with what the rating should be. And, so, in my view maybe the BBB was a little bit more like a BBB+. And, you know, I had also been told and had the idea that they were really made to be sold to insurance companies and that sort of thing. They were meant to be a bond where they took all these things and structured things that looked like a bond. And it just makes it so easy, I put that in one of my letters too, that it made it so easy to accept this risk. And, I thought that those, initially when it was put out I thought that it would jump. I thought that people would be buying it and that it would be a very popular product in terms of people wanting to buy it.

FCIC: In going along and taking the long side of it?

MB: Right, right. Taking the long side of it and the opposite of what I was doing. And so then, as far as the policy of having those still around … I don't think those are still around. Wasn't '07-2 the last one? Yeah, I think so.

FCIC: So which was more important this time just spreading contagion or just being bad for the mortgage market? The synthetic CDO, or the AVX index? I mean which of these do you think was used more?

MB: I have no …. I don't know. I just don't know. At the time, I think I put it in my letters, I think that they were both at work in the market.

FCIC: Sorry, I'm always trying to unpack different elements with this to better explain causality and the timing of causality. There are arguments that academics and others make that, and you are suggesting in some way too, that the existence of the synthetic market amplified the housing bubble. So the question then becomes was it, and I'm sorry, when I say the synthetics market I really do mean the RMBS CDS and synthetic CDOs rather than in my terminology cash CDOS. Because it's a slightly different argument if you will. So, I think the argument goes that, dealers or originators or anyone in the mortgage marketplace, once they had an ability to short, were even less concerned with the actual mortgages and the real stuff that they were creating because they had a hedge against it.

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That's sort of one stage of the argument or hypothesis if you will. Another stage is just, by this market taking off and various people placing lots of different bets in it, that certain institutions lost a lot of money and certain other folks made money. But, the folks who lost tended to be systemically important institutions. So, it affected credit creation and the economy and etc. Would you care to comment on any of that or change those hypothesis or anything?

MB: I really do want to help you understand this, but I don't know if I can add much to either of those thoughts. As it turned out, derivatives were the reason that so many of these companies got in trouble. My argument is a little more simple.

FCIC: When you say these companies, who do you mean?

MB: Our dealers; AIG. I just think that like most of our arguments mine are a little more simple. I just thought that, you know, as it turned out, derivatives were hugely important to the businesses of some of our most important institutions. And, somehow, one way or the other, I thought (I think at one point) it was truly their hedging also. I lost that thought later but early on I thought it was for the banks to do, too… the hedging. I thought a lot of it would be hedging initially. But clearly there was a lot of directionality in this with a lot of our institutions in this. And I think it just proves the point that we can't handle it. There's some other issues with it too which aren't my direct experience regarding that natter, which you've probably heard of. And I think that there is a … Again, a lot of this stuff I am finding out now through new sources, so I can't really comment … I'm trying to comment just on my thoughts from what my experience was.

FCIC: We're also interested in your opinions based on your … your experience would allow you to make judgments and accumulated wisdom about this marketplace. So, we're … I am asking you beyond your direct experience for your views.

And if I could add specifically, it would be about a point that you just raised about finding out some of this stuff now from the news accounts… I mean, could you comment on transparency and how there was a lack thereof. And how that affected your experience in dealing with the counterparties and how that may have affected how people could view their market generally and actually measure the risk that was there?

MB: Well, it was a dark market. It's not a transparent market.

FCIC: I'm sort of wondering just how you ever would have heard about a master agreement.

MB: Ok, so originally what happened there was … this is not very relevant so I'll say it pretty quickly. I was onto WorldCom pretty quickly and they went from investment grade to bankrupt overnight. So I ended up doing ok with their bonds on the way back up, but, I wondered why didn't I make more money on this? And I wasn't a short. I don't like to short equities. I'm not generally a short guy, so I basically noted though that it went from investment grade to bankrupt overnight. So it hit me, that's the way to short. Companies that you think look so gilded now, but you think might tumble, with asymmetric risk taking. So, especially leveraged companies, and I noted that there were a lot of these highly rated super

leveraged companies where you could buy credit, because you can't buy credit default swaps on junk, or stuff that's below investment grade, so… That was how I came to investigate CDS's so I bought books. I bought Janet Tavakoli's 1998 book and that was the first book I read.

FCIC: That didn't sell quite as many copies as The Big Short(laughter)

MB: But it was helpful. I didn't take all of those equations and buy them, but I basically got the basics of the market from that. And then it's just a matter of … the other opaque market but nowhere near as systemically significant is the junk bond market. In 2002 I was very active in the junk bond market. And, I made a lot of contacts with these dealers initially in the junk bond market and then moved because it was pretty easy. I mean it was, "Oh hey, if I want to trade CDS what do I do?" And then just move over, because itwasn't something too exotic.

FCIC: So you said that the standardization was actually a bad thing, but that actually seems to be where the treasury and the congress is going right now…?

MB: Well the idea is to standardize everything so that you could have this really open and transparent market. The problem is that you have this mass delusion and nobody wanted to stop it. So, I think that stocks are freely trading and we still have the dotcom bubble. I mean like, there are these mass delusions and everybody wants to do it, then there's no stopping it unless it just doesn't exist. I just don't think that we can trust our society, and I can get into it, but I don't think we can trust us to recognize it. I'm still waiting for a president to say, "We're gonna have a recession. It will be a little one, but it will save us a bigger one later." But we won't get that I don't think. So I think we need to take the scissors our ofout hands.

FCIC: So you mentioned Milton's Opus before and I was just wondering what you had in mind with that.

MB: Well that was my attempt to rapidly expand the size of my bet. So, it didn't work and I wasn't able to raise money for it. I didn't market it too heavily, but that was the intent which was to do a lot more of these trades.

FCIC: By raising more capital to …?

MB: Right, because I had a fund that … there was limits as to how far I could take this trade in my fund. It was a diverse; it was a fund that invested in stocks generally and debt instruments sometimes. And credit derivatives were within our purview but it didn't feel good to make it too big within the fund. So I said, "OK we're at a good size now, I still want to do more of this, so let's open a separate fund for it."

FCIC: So why, I'm sorry if you answered this before and I didn't hear it. What price were you charged for you CDS protection, generally speaking?

MB: On residential mortgage backed securities?

FCIC: Mm-hmm. (yes) The range of basis points for the protection …?

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MB: For BBB- or BA3 it was … I think it was between 140 and 275 or something like that I would imagine. And then with BBB, or BA2's it was probably like 85 to about 185. And these are basis points.

FCIC: Right. And, sorry just to get back briefly… Just back to Gregg Lipmann and Deutsche Bank. Did you ever see his presentation how to short mezzanine tranches and subprime…?

MB: No. It really gets to how I don't talk to people. (Laughter)

FCIC: OK. I just want to make sure in case we cut that off a little earlier. I just wanted to make sure there wasn't any more interaction with him. If there was back and forth with this idea…

MB: Not at all. No. There was just that one day.

FCIC: OK. Thank you. So, the last couple of questions then since everyone's done, which are the questions that we tend to ask everyone. Anyone that you think would make sense for us to talk to which would help us to understand how derivatives and the financial crisis.

MB: Boy there's a good way to make friends … (laughter)

FCIC: We keep it all confidential. We don't say, "Dr. Burry told us to call you." Unless you think that would help. I see where you're lawyer's mentioned in the book sums Dustin. Who was involved in the negotiating…?

MB: He was, but the thing was I negotiated it and he is really more of my COO and was more responsible for other people mostly. He was … I was with the one that basically directed it. And the problem with me is that I don't talk to anybody, and I did all this on my own; none of my other analysts worked on it. Steve just did a few things at my direction, so he wasn't himself very involved. You know, for reviewing our initial instant agreements I had outside council for that.

FCIC: Who was that?

MB: We're talking so many lawyers, no offense to anyone (laughter). Um, Robert something? I can get you the information, but he was the … he is the guy. I mean I probably got it from one of the dealers, but he is the guy. Somewhere out here, it was in Washington, D.C.

FCIC: If you could let us know then that would be great. And then my last question is, you have mentioned both way back when we talked on the phone and then here again today that you wanted to help us to understand. Is there anything that you haven't told us to help us understand?

MB: Yeah I think my monologue a while ago kind of got that across. But, I guess the one point that I would make is that it's a mistake, given the position of what you are trying to do now, it's a mistake to lay all of the blame on one institution or one set of institutions. And I think for us to learn as a society, I think that we all need to take some of the blame.

FCIC:Ok, well thank you very much for your time. We very much appreciate you coming in, and particularly traveling across the country. It was very nice of you to do that, so thank you very much.

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MB: Alright, thank you.

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