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The Bank Everyone Loves to Hate

Goldman Sachs's CEO says the firm got no special treatment during the bailout—and he intends to pay bonuses this year.

By HOLMAN W. JENKINS JR.

Rightly or wrongly, a business occasionally is picked out by the fates to serve as the "unacceptable face of capitalism"—a term coined by the late British Prime Minister Edward Heath. Goldman Sachs, for a lot of people, is today's UFC.

The kinder jokes refer to the legendary investment firm as "Government Sachs," because of its connections to former Treasury Secretary Hank Paulson (once a Goldman CEO) and other alumni who, as Washington officials, had hands in last year's financial crisis rescue operations. More rudely, a writer in Rolling Stone magazine likened Goldman to a "great vampire squid wrapped around the face of humanity, relentlessly jamming its blood funnel into anything that smells like money."

Of the five major investment banks that walked the earth little over a year ago, only two survive—Goldman and Morgan Stanley. Lehman is dead; Bear Stearns and Merrill have been absorbed by commercial banks. Even in surviving, the cost in reputation for Goldman has been unmistakably if obscurely higher than for its fellow survivor, Morgan Stanley.

Sitting across from me now in his comfortable office on the 30th floor of company headquarters in lower Manhattan, Goldman's CEO Lloyd Blankfein professes to be more bemused than hurt by the slurs. I suppose his serenity may be helped by the fact that the events we're discussing—Goldman's brush with death—appear to be firmly in the past.

He defends all that he considers exemplary about the firm: its disciplined risk taking; that 90% of its revenue and profits are generated in service to clients; that it's not just a giant hedge fund, as some critics say; that it plays a vital social role in matching those who have capital with those who need it; that its partners frequently retire young to devote themselves to philanthropy or public service.

Yes, he acknowledges, the presence of so many former Goldmanites in top echelons of government gives some the impression of a firm pulling strings (he says it doesn't). "But," he says, "I bet when things have settled down, it will again be considered a positive for people to put their pursuit of personal wealth aside and go into government service."

Yet the question hovering up near the fluorescent lights—of whether he and his colleagues owe their again-growing fortunes to a government bailout—is not an easy one, for him or us. It's also a question that may also become a tad less academic in the weeks ahead as Goldman, thanks in part to the panic that widened market spreads, prepares to dump embarrassingly large bonuses on its partners at year-end. This may or may not provoke a fresh round of undersea metaphors and political attacks on the firm.

In the meantime, the cherubic and youthful Mr. Blankfein's own payout after the bubble year of 2006—some $53 million—has already come back to haunt him in many media accounts. The son of a postal clerk, he grew up in a Brooklyn housing project and worked his way out via Harvard and Harvard Law. Today he still makes his way in a tough neighborhood, though the rewards are a lot better.

Think back to that frantic week in September 2008 when Lehman failed, AIG teetered, money-market funds verged on a meltdown, and even great corporations like GE feared no longer being able roll over their short-term debts. Mr. Blankfein says now he is thankful for the government interventions that stabilized the crisis, but he resists drawing an obvious corollary—a corollary that has become even more obvious amid recent revelations about just how strenuous were Washington's efforts to keep Goldman and Morgan Stanley alive, even if it meant shotgunning them into marriages with giant commercial banks like J.P. Morgan or Citigroup.

That corollary: For now, Washington regards Goldman as "too big to fail," putting an effective taxpayer guarantee under the firm, opulent bonuses and all.

Had the financial system collapsed, Mr. Blankfein unhesitatingly acknowledges, "We would have been in that snowball tumbling down the hill with everybody else. It would be ludicrous to say otherwise. As a member of the system, we were all at risk. I will tell you I was more scared than you, because I was closer to it and I knew more. If you had known as much I did, you would have been as scared as I was."

But he also insists that Goldman was not especially at risk. On the contrary, it came through the crisis without suffering nearly the losses of its Wall Street confrères. "People say, 'Oh, you would have failed, blah, blah.' Well, I didn't think so. Our liquidity was huge. I knew what our liquidity and cash was. It felt OK, but let me tell you, there was getting to be 'run' elements to it."

That said, he most evinces today regret that Goldman couldn't have kept a greater distance from government bailout efforts. It didn't occur to him at the time, he says, that he could have stayed away from Hank Paulson's famous confab, in which the Treasury secretary (and Goldman alum) forced the nation's nine biggest banks and investment banks to accept infusions of government capital. Mr. Blankfein emphasizes that Goldman didn't need the money and subsequently paid it back.

In another extraordinary measure, the FDIC enabled Goldman and other financial institutions to bulk up their cash by issuing FDIC-guaranteed debt. Says Mr. Blankfein: "Being Goldman Sachs and overachievers that we were, we were the first ones to do it. I didn't know it would be a pejorative. At the time I thought it was a good thing. In retrospect, I'm glad we stopped at 22 [billion]. I wish we'd stopped at zero."

Then there were the attempts by Fed and Treasury, in the heat of the crisis, to wed Goldman to Citigroup or Wachovia. Mr. Blankfein dismisses these brainstorms today as the sort of ideas that sounded good at the time. "If people had voted, people would have liked to see Goldman Sachs drop all its activities and merge with Citigroup. That wouldn't have been good for Citi, it wouldn't have been good for Goldman, and it wouldn't have been good for the country."

What's striking today is the cumulative significance of these exertions. In trying to save the system, the government was trying to save Goldman; in trying to save Goldman, it was trying to save the system. Goldman=system, is a good summary of so many snide mutterings.

Mr. Blankfein prefers to emphasize the role of Goldman's self-help initiatives. The firm sped up what he describes as a long-pending application before the Fed to become a bank holding company, allowing Goldman to get out from under its primary regulator, the Securities and Exchange Commission. The SEC's imprimatur, he says, had become worthless after the Bear Stearns and Lehman debacles. "What it looked like at the time was, the Fed had regulated its institutions well, and its validation was a good imprimatur. And the SEC had failed in its supervision, and its validation wasn't good."

Two days later, he raised $5 billion from Warren Buffett, followed by an oversubscribed $5 billion sale of Goldman shares in the stock market. "Warren Buffett put his money where his mouth is and said, 'I'll bet $5 billion that Goldman Sachs is fine.'" The impact on client and investor confidence, Mr. Blankfein adds, was "huge" and instantaneous.

But the question remains: If Mr. Buffett gave the market confidence, what gave Mr. Buffett confidence?

Then there's the matter of AIG, source of snarling recriminations even among Goldman's Wall Street brethren. If AIG, a huge player in all kinds of markets, had gone down, the impact on the economy would have been incalculable. Mr. Paulson and Fed Chief Ben Bernanke wouldn't risk it. They reversed course after Lehman and bailed out the insurance giant to a tune that now has reached $180 billion. To this day, charges fly that the AIG bailout was a backdoor bailout of Goldman.

AIG had been a big issuer of guarantees on subprime-backed paper; Goldman had been a big buyer of those guarantees. Nonetheless, when government officials rang up to ask what would be the potential impact of an AIG bankruptcy on Goldman, Mr. Blankfein says his answer was: "negligible." He did not, he says, ask Washington to save AIG: "It never occurred to me, having lived through Lehman Brothers weekend, that there was government money for anything. People wanted to know how we were going to do when AIG went down. I was telling them we were fine."

Mr. Blankfein points to what he calls a fundamental aspect of Goldman culture—its risk-management discipline. AIG had been regarded on Wall Street as a gold-plated client, not just a "Street" counterparty. But Goldman had nonetheless taken the usual step of requiring AIG to post collateral nightly against any deterioration in the market value of the guaranteed assets.

Mr. Blankfein placed some of the phone calls himself. "AIG was being beastly, difficult to deal with, not responding well to our calls for collateral. And I called them up and fought with them, and it was always because they were disagreeing with our 'marks.' They never said, and I never had reason to suspect, 'We're illiquid. We don't have the money.' It never occurred to me."

Goldman, in its rigor, reinsured any shortfall with other counterparties, who were also required to post collateral nightly. "We had one day of exposure with them. It doesn't mean I can't lose $300 million if they don't pay because that's how much a market can move in a day, but basically I'm not worried about it."

These estimates, of course, have a theoretical element. The underlying assets would certainly have collapsed even further in value if Wall Street firms and AIG began dropping like nine-pins. We'll never know. In the event, AIG was rescued—though that now meant that taxpayer money, in a sense, was being shipped to Goldman to meet AIG's collateral obligations.

Some say today the government should have spurned Goldman's collateral demands. Some say it should even have forced Goldman to settle the outstanding positions at a discount.

Realistically, though, AIG faced hundreds of counterparties; and short of bankruptcy, which Washington had ruled out for AIG, no obvious formula presented itself for rewriting thousands of AIG contracts without risking the market panic Washington was trying to forestall. For its part, Goldman would have been on thin ice with its own shareholders if it had voluntarily relinquished valuable contract rights to make nice with Washington.

Conspiracy theories always leap to the fore amid big and consequential events. They especially appeal to people who are more familiar with Hollywood's idea of how the world works than with how the world works. There can be little doubt Mr. Blankfein was looking after his firm, while Paulson & Co. were looking to stave off an economic meltdown. The real problem here—the problem of "too big to fail"—is not a matter of conspiracy, but of self-fulfilling market perception.

If lenders believe government stands behind a firm, that firm can borrow more cheaply than its rivals. It can grab market share and grow beyond what an otherwise disciplined market would permit, potentially becoming the next Fannie or Freddie.

Mr. Blankfein is hard pressed not to acknowledge that, in some sense, Goldman may be entering this territory. "If you think it's too big to fail, whatever that means, then maybe you're more likely to lend to me a low rate. As far as my motivation is concerned, I have my wealth and fortune and everything I have accumulated over my lifetime at risk in this firm. And that could go to zero. Who fails beyond that? They don't put you in debtors prison. They don't beat you."

Goldman partners, he points out, receive a sizeable chunk of their pay in stock and are required to maintain their ownership stake until retirement. Creditors might take comfort from too big to fail, but the people running the firm can't—Bear Stearns may have been "bailed out," in some sense, but its shareholders got killed, he notes.

All true—and yet no comfort against the possibility of miscalculation, of competitive heat or simple bad luck. Lehman, Bear, AIG, Washington Mutual, Wachovia, Countrywide, Fannie and Freddie all were run by executives with substantial wealth tied up in their stock. They blew up anyway. Meanwhile, their creditors were bailed out—creditors who supplied the leverage to let banks become too big to fail in the first place and would likely do so again.

It's no use blaming Goldman for this. Only Washington can fix too big to fail by creating a credible liquidation regime to convince creditors that government won't just bail them out. Lenders then might lose their appetite for enabling the kinds of firms that cause regulators and policy makers to lie awake at night.

In the meantime, what about those Goldman bonuses? Mr. Blankfein frankly says that if the choice is between satisfying the political furies and keeping his people happy, he will keep his people happy. "The core of Goldman Sachs's performance, success and longevity over this period, aside from luck, is that we've put ourselves in a position to be more lucky, because of our people. And I have an obligation to keep the firm and the franchise intact."

It may be the worst time to be a Goldman Sachs partner—but it's still a good time to be a Goldman Sachs partner.

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