4-26-2010

FCIC memo of staff interview with William Ackman

William Ackman

Brad Bondi

Victor Cunicelli

Thomas Borgers

MEMORANDUM FOR THE RECORD

Event: Interview with William A. Ackman

Type of Event: Phone Interview

Date of Event: April 23, 2010; 12:45 p.m.

Team Leader: Brad Bondi

Location: 888 Seventh Ave. 42nd Flr., NY, NY 10019

Participants - Non-Commission:

- William A. Ackman, Pershing Square Capital

Participants - Commission:

- Brad Bondi
- Vic Cunicelli
- Tom Borgers

MFR Prepared by: Vic Cunicelli

Date of MFR: April 26, 2010

Summary of the Interview or Submission:

On the above date and time, reporting investigator (RI), Deputy General Counsel Brad Bondi, and Senior Investigator Tom Borgers interviewed Mr. William Ackman. Mr. Ackman heads the Pershing Square Capital management hedge fund. Mr. Ackman attempted to warn regulators and credit rating agencies of MBIA's leverage. Mr. Ackman said as follows:

Rating agencies have several problems which compromise their ability to provide accurate ratings:

- for profit model
- analysts are improperly incented
- ratings shopping (by issuers)
- liability exemption
- monopolistic/oligarchic

- weaker standards=higher profits
- unwillingness to say "no" (everything gets rated).

Boaz Meinstein would be an excellent witness on a prospective panel relating to rating agencies, he's a friend of Ackman and runs a credit hedge fund. He's a "pure credit analyst." Another independent voice is Fiachra O'Driscoll, a senior credit analyst at First Boston who oversaw the construction of the open source model. He can explain CDO construction and sales. Jim Grant of Interest Rate Observer would also make a good witness.

Ackman provided a presentation entitled, "Who's Holding the Bag" dated May 2007. The presentation questioned assumptions rating agencies made in rating ABS/CDOs. It portrays a common misconception that rating agencies act in place of regulators. It explains the difference between regulators and rating agencies. It posits that a 9% to investors in CDOs makes all capital through BBB worthless, but notes senior tranches typically are guaranteed by bond insurers. The remainder of the presentation displays in detail how these financial guarantors (largely MBIA and Ambac) are grossly undercapitalized. Ackman provided regulators this presentation and has a body of email correspondence with regulators, MBIA (Board of Directors), and RAs (Moody's Chief Credit Officer-Chris Mahoney) which he will produce for FCIC. He says they "can't say they didn't know."

MBIA had risk, "hidden in an entity with no ability to absorb risk." He believes MBIA encouraged the SEC and NY AG to investigate him. Asked why he chose to short MBIA, he said MBIA was "crooked and stupid" where Ambac was simply "stupid." MBIA used insurance company capital to guarantee derivatives, an act which is illegal in NY. They set up "transformer" SPV in order to get around the NY Insurance Department rules. He missed AIG, assuming that Hank Greenberg was too smart to get caught so short on capital.

The principal cause of the financial crisis is the rating agencies' incompetent execution of their respective jobs added to lax regulation. He said AAA ratings caused people to look elsewhere for risk. The Basel II caused demand for products with high yield and AAA ratings. Basel II further excused enterprises from holding capital against AAA ratings. AAA rating was an excuse not to do due diligence. The people constructing the CDO deals knew the risks, the institutions did not. Improper incentive structure encouraged those who knew the risks to do the deals anyway and lay the risk off on buyers. Hedge funds saw the risk because there is little distance between individuals who have money at risk and the particulars of the deal. Banks did not see the risk as they had many layers between managers who called the shot and the individuals who dealt with the particulars of the deals.

Markets are efficient at filling demand. The creation of the CDO was the market's response to BBB RMBS nobody wanted to buy. BBB securities were packed into CDOs with AAA ratings and were suddenly saleable. CDO^2 products were the next logical step in the progression. Several CDO^3 were composed around the time the market locked up. Risk goes to the most leveraged, least regulated and least transparent areas of the market; usually where market participants are not investing their own money.

36CFR1256.56: Privacy [redacted] Moody's and S&P do not need to collude. They each publicly list standards. They do not need to collude.