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Goldman Sachs Response to FCIC regarding AIG Trades not included as a part of the Matched Book

Goldman Sachs

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The Commission asked whether there were additional counterparties to the super senior credit default swap trades that we executed with AIGFP. On July 16, 2010 we provided information on the counterparties to whom we sold credit protection referencing the same securities on which we purchased protection from AIGFP.

In addition to these credit default swap trades, between May 2005 and February 2007, we bought approximately \$6 billion notional of super senior tranching credit default swap (CDS) protection from AIGFP on seven reference portfolios related to ABACUS transactions. In contrast to a single-name CDS (which references one specific mortgage backed security (MBS) or asset backed security (ABS)), a tranching CDS references an entire portfolio of MBS and/or ABS with a designated attachment and detachment point.

Five of these super senior transactions, which had a notional value of \$5.2 billion, were executed between May and November 2005. AIGFP took an active role in negotiating both specific aspects of the reference portfolios and the legal terms with respect to the transactions. In the first quarter of 2006, AIGFP notified market participants that it would no longer take incremental exposure to CDO tranches that referenced mezzanine subprime RMBS. Subsequently, AIGFP wrote credit protection to Goldman Sachs on the super senior tranches of two synthetic CDOs referencing exclusively commercial mortgage-backed securities (CMBS) and other commercial real estate-related obligations (with no subprime RMBS).

These ABACUS super senior CDS transactions with AIGFP were not “back-to-back” trades (i.e., having a simultaneous sale of offsetting tranching CDS protection to a different counterparty). Rather, traders managed the risk of these and all the other trades in the book as a whole. Traders utilized ABX, CMBX, single-name CDS, TRS and cash securities to hedge these and other tranching CDS trades to adjust the overall risk profile of the book and achieve a generally balanced position as market prices fluctuated over time. Hedging using indices, single-name CDS, TRS or cash securities in this manner requires a dynamic risk management approach. Hedges must be monitored frequently and, on occasion, rebalanced because tranching CDS are option-like instruments that are tied to the market price of (and credit losses on) the reference portfolio. As with any derivative having an option-like profile, the risk profile changes not only as the underlying instruments change in value, but also with the passage of time.

None of the above ABACUS super senior CDS transactions were included in the Maiden Lane III transaction. On July 15, 2010, we provided the Commission the status of each trade that was not included in Maiden Lane III, including the net proceeds received for all trades which were terminated.