

LOSING LUSTER

GOLDMAN SACHS UNDER LLOYD BLANKFEIN



BREAKINGVIEWS



REUTERS



LOSING LUSTER

GOLDMAN SACHS UNDER LLOYD BLANKFEIN

BREAKINGVIEWS



FRONT COVER: *REUTERS/Chip East*

CONTENTS

Preface	4
Chapter 1 – The handover	6
Chapter 2 – Golden years	9
Chapter 3 – Rough ride	18
Chapter 4 – The backlash	26
Chapter 5 – In the dock	36
Chapter 6 – Mixed messages	43
Chapter 7 – The future	56



PREFACE

Nothing attracts public opprobrium for the financial industry more than Goldman Sachs and its boss Lloyd Blankfein. Rivals suffered far greater losses and required more government aid. Some even went belly up. But Blankfein and the firm he has run since June 2006 have become the personification of all that's wrong with the system.

For one, he's among the few bank bosses to keep his job. That makes him a more legitimate target for ire than those who have been parachuted into senior roles at weakened banks or ushered into obscurity. But it's hardly the only reason Blankfein and Goldman have been so lambasted.

Goldman's problems derive from its success. The Wall Street titan dominated investment banking league tables, raked in trading profits and generated the best returns on equity. It was phenomenally well regarded and connected. Blankfein's predecessor, Hank Paulson, became U.S. Treasury Secretary. And no firm's employees were so well rewarded; Blankfein's 2007 bonus, at \$68 million, outstripped all peers.

The firm earned envy and respect. Others benchmarked their own performance against Goldman's. Its reputation seemed even more assured early in the housing slump as the firm sidestepped the embarrassing losses that so damaged others.

That changed as the crisis worsened. What previously counted as Goldman's smart risk management morphed in the public consciousness into Goldman and its bankers cynically profiting at everyone else's expense.

Dysfunction elsewhere occasionally stole the limelight. But the story always circled back to Goldman. Rolling Stone magazine branded the firm a "great vampire squid wrapped around the face of humanity," a moniker destined to stick. Twitter accounts poke fun at Goldman's top PR man and air select conversations overheard in the elevator of the firm's shiny new, lower Manhattan headquarters.

A \$550 million fine imposed by the Securities and Exchange Commission cemented Goldman's fall from grace. The regulator charged the firm with

BREAKINGVIEWS

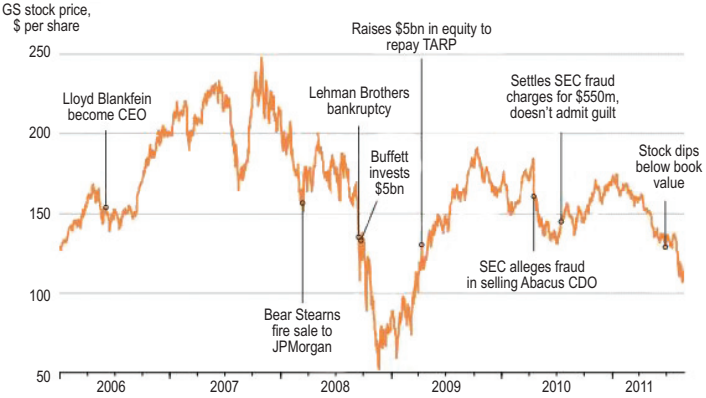
misleading investors in Abacus, a now infamous mortgage-backed collateralized debt obligation, even though the buyers were seasoned mortgage experts.

The firm’s responses didn’t generally help. Blankfein’s offhanded joke about doing “God’s work” and the board’s decision to double his bonus in 2010 despite the firm’s slipping results came off as yet more arrogance. Uncomfortable appearances before Congress, regulatory changes and a couple of trading slip-ups added to the woe. And Goldman’s shares – at the time of writing – were trading ignominiously below book value.

The articles selected for this book chronicle Goldman’s bumpy ride under Blankfein over the last five years from virtually untouchable to basically unremarkable. It might even be a candidate for a breakup. Of course, Goldman has been here before. The question is not just whether Goldman can rise again, but whether in the face of a new regulatory regime it can do so without a change to its corporate structure – and perhaps its management.

Antony Currie
September 2011

Key events during Blankfein’s reign



Source: Thomson Reuters Datastream

Reuters graphic/Van Tsui 8/31/2011



CHAPTER 1

THE HANDOVER

HAWKING AMERICA

BY ROB COX

Goldman Sachs boss Hank Paulson already has one of the best jobs in the world. So why would he trade leadership of Wall Street's premier firm for a bit role in a dying regime?

Under President Bush, the Treasury Secretary's job has been gutted like a bass at a fish market. Paulson's predecessors failed to influence policy meaningfully. Deficits widened and the dollar dropped. Alan Greenspan's flooding of the market with liquidity really kept the economy moving. What's Paulson thinking?

In one respect, his departure from Wall Street looks timely. It is hard to imagine a more Goldmanlocks economic scenario: interest rates are still low by historical standards; companies, private equity firms and hedge funds are awash in cash; M&A is at a cyclical peak; and securities trading volumes are booming.

Goldman recently reported mind-blowing profits. The stock, while off its highs, is up 60 percent in a year and has tripled since Paulson led its IPO. So leaving now with about \$700 million of stock under his belt seems sensible. That's especially true given the dominance of the trading businesses to Goldman's bottom line. It's only natural that a former client banker like Paulson would now pass the baton to Lloyd Blankfein and his merry traders.

But it would be disingenuous to view this as a simple trade at the top. Patriotism undoubtedly plays a role. And Paulson must have felt some obligation given Goldman's emerging role as a sort of "Team America" supplying the human capital to sort out the nation's fiscal problems. Moreover, one suspects Paulson felt there is plenty of work needed to be done to prepare America's finances for more difficult times.

BREAKINGVIEWS

The dollar's recent decline reflects eroding confidence that America can keep spending profligately without consequence. With a greater percentage of government debt held by foreigners, it is imperative the nation has an articulate and persuasive chief financial officer. That Paulson is a known quantity in Beijing and other capitals that increasingly influence America's financial destiny, only adds to his attraction as Treasury boss.

For the sake of the country, and its creditors, one can only hope the president lets his third Treasury boss do the job.

Published on May 30, 2006

LLOYD OF THE BOARD

BY ROB COX

Goldman Sachs has missed the chance to do something radical with Hank Paulson's departure for the Treasury. On Friday, Lloyd Blankfein was appointed to succeed him as chairman and chief executive of the investment bank. Goldman should have split these roles. Not just to please corporate governance sticklers. It would have been good for business.

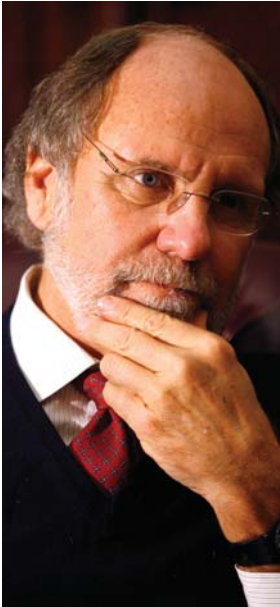
Goldman has come a long way since Paulson led it to public ownership in 1999. Since then the biggest growth in business has come in the bank's clever use of its capital – both as a trader for its own account and in the service of clients.

The Goldman principle is that those who put up the biggest numbers call the shots. So it follows that Blankfein, the trader's trader, should become chief executive. But Goldman must recognize there is a tension between the principal side of the business and the more traditional activities of the firm, where it helps customers raise money and do deals.

This tension has intensified recently after a series of leveraged takeover approaches in the UK ruffled feathers. That gave the impression the traders were running the business while those serving corporate clients play second fiddle.

As a highly regarded relationship banker, Paulson sought to defuse this tension by keeping the traders in check. He had the credibility and the authority for his voice to be heard. It is not entirely apparent that Blankfein can provide the same balance now that he occupies both roles. Appointing a chairman with the Paulson touch would have sent a clearer signal that Goldman's top priority remains serving its clients.

Published on June 2, 2006



TRIPLE THREAT - Only three men have run Goldman Sachs since 1994 – from left to right, Jon Corzine, Henry Paulson and Lloyd Blankfein, who took over in 2006. REUTERS/Tim Shaffer, REUTERS/Larry Downing, REUTERS/Chip East

CHAPTER 2

GOLDEN YEARS

GOLDMAN'S MANDARIN LESSON

BY HUGO DIXON

Goldman Sachs certainly knows a good deal. Like buying a 7 percent stake in China's largest bank for only 40 percent of what it is worth, effectively making a \$4 billion profit in the process.

One can, of course, be sceptical about Chinese bank balance sheets. Have all those bad debts really been taken into account? On that view, even paying 1.2 times book - what Goldman is paying for its \$2.6 billion stake in Industrial & Commercial Bank of China (ICBC) - is risky.

But look at another yardstick: the market. ICBC itself hasn't yet gone public. But China Construction Bank (CCB), the country's third largest, did go public last year - and is now trading on 3.1 times book. On that yardstick, Goldman's \$2.6 billion stake would be worth \$6.6 billion. Hence, the \$4 billion notional gain.

Goldman isn't the only Western financial institution benefiting from investing in Chinese banks. Bank of America, for example, is already sitting on a \$4 billion-plus paper profit on its original \$2.5 billion investment in CCB - which it bought at roughly the same multiple of book that Goldman is now paying. But there is a difference. Bank of America came in before there was a public value for a big Chinese bank. Although Goldman's deal has been brewing for some time, it has been finalised after the market has had its say.

Equally, Goldman isn't the only Western financial institution getting good terms for buying into ICBC. Allianz is investing \$1 billion and American Express \$200 million. But again there is a difference. Not only has Goldman got the lion's share of the deal; it is not nearly as obvious what it brings to the party.



REUTERS



CHINESE TAKEAWAY - Goldman Sachs got a good deal on its investment in ICBC, which raised \$19 billion in the world's biggest IPO in 2006. REUTERS/Paul Young

Sure, the investment bank is going to teach the Chinese risk management and give guidance on internal controls and corporate governance. But that doesn't look as strategic as Allianz teaching ICBC how to sell insurance to its 100 million customers or American Express giving guidance on how to hook them on charge cards.

So how has Goldman pulled it off? Probably because it has long been close to ICBC, although it isn't officially its adviser. Maybe the Chinese should have sought an independent opinion.

Published on Jan. 27, 2006

GOLDMAN ARCHES

BY HUGO DIXON

The big talking point in London is the backlash against Goldman Sachs among corporate clients. How can the investment bank be trusted as an adviser when it is seemingly on a rampage, making quasi-hostile bids for public companies? How much can it be relied upon to act in your interests when it is also acting for some of your most bitter rivals?

There has long been grumbling about Goldman's multiple conflicts of interest. But, in general, companies have been impressed by the bank's power and acumen. They have tended to conclude that they are better off having it working for them – albeit not in an exclusive fashion – than working against them. What is astonishing about the past week has been the willingness of chairmen and chief executives to make their displeasure known, albeit off the record. The result is the industry's most envied corporate franchise is in danger of erosion in the UK.

The trigger has been Goldman's involvement in no fewer than four quasi-hostile approaches for large British companies: ITV, the broadcaster; BAA, which owns Heathrow airport; Mitchells & Butlers, a pub chain; and ABP, the ports group. Goldman wasn't simply advising on these approaches. It was proposing to invest as a principal.

With so many companies being assaulted simultaneously, corporate chieftains seem to have concluded there is safety in numbers and have made their displeasure known. So much so that Hank Paulson, Goldman's longstanding boss, had to issue an edict telling his bankers to think carefully before engaging in activity that could be portrayed as hostile.

This intervention appears to have been a massive PR blunder. It has made the issue of Goldman's behaviour a legitimate talking point. Paulson didn't return requests to comment.

The issue isn't just whether Goldman can be trusted as an adviser when it is making quasi-hostile approaches to other public companies. It has also been criticized for a curious "dual-track" approach. Take BAA. When the airports group faced a hostile approach from a Spanish construction company, Goldman asked to defend it. As part of its pitch, it also offered to buy the company.

One way of viewing this is as offering a full service to clients. Another is that Goldman was exposing itself to a conflict of interest. Could BAA rely on the firm to tell it what was in its interest when it potentially had so much to gain from buying the company? No wonder Goldman was shown the door. When it tried a similar dual-track approach a couple of years ago with Sainsbury, a big UK supermarket chain, it was fired as an adviser.

Then there is the separate issue of whether Goldman can be trusted when it is acting for rivals. This is one reason why BSkyB, the UK pay-TV company controlled by the Murdoch family, dismissed Goldman as its corporate broker just before Easter.

Why is all this happening? Probably because there is much more money to be made in the short term from doing deals than nurturing long-term relationships. This is also the philosophy of the super-charged traders, who increasingly dominate Goldman's higher echelons just beneath Paulson, a former investment banker.

It is unclear how the internal struggle will play out. Paulson's edict may have temporarily tilted the emphasis back to long-term relations. But there must be a chance that greed will put the traders back in the driver's seat before long. Whichever way, Goldman's ability to both parade as a trusted adviser and play the field aggressively itself is probably unsustainable.

Published on April 21, 2006



OCCASIONALLY GROUNDED - Conflicts of interest have always surrounded Goldman, as when, in 2006, it sought to defend airports operator BAA from a hostile takeover approach while also offering to buy it.
REUTERS/Toby Melville

GOLDMAN'S GOLDEN RING

BY ROB COX

Goldman Sachs is the Google of Wall Street. In the same way that Google recruits the best and brightest in Silicon Valley, Goldman is the financial temple that excels best in attracting the most talented adherents to the religion of money. One of the critical ways it has continued to do this despite becoming a public company seven years ago is by keeping the inner sanctum of its partnership intact.

Every two years the firm anoints its top producers to the title of partner. It just named 115 of these lucky men and women to its 2006 crop. This doesn't just confer a new character on their Japanese business cards. It allows them to fillet the tenderloin of the investment bank's bonus pool. As Goldman is on track to earn more than any other securities firm this amounts to one of the greatest payouts in Wall Street history.

How big? The year's not yet over and Goldman doesn't reveal how it sprinkles the gold dust around. But one can approximate. Last year, the group's 287 partners divvied up \$2 billion. Assume the size of the bonus pool relative to the company's net income remains unchanged. Profits, however, are expected to rise by 50 percent to \$8.4 billion. On that basis, the partners' pool would expand to \$3 billion.

This year's list of new partners is the most ever at Goldman. In 2000, another boom year, the firm added 114 partners. Relative to overall employment, however, that represented an even larger slice of the firm than today's expansion. But the relationship that matters most is to profits. And these have nearly tripled since 2000. To the victors of this latest round of promotions go some extreme spoils.

Published on Oct. 26, 2006

HIGH-WATER HARBINGER

BY ANTONY CURRIE

Wall Street crisis? What crisis? That would appear to be the message from Goldman Sachs' record first-quarter earnings of \$3.2 billion – which beat expectations by a quarter. The bank's trading desks powered ahead, generating revenue growth of more than 50 percent from the fourth quarter. These more than offset declines in fees at the hedge funds it oversees. But as stellar a sign this might appear for Wall Street, Goldman's bumper showing may not be a perfect guide for investors to follow.

For starters, Goldman closed its books for the first three months of its fiscal year on the last Friday in February – as rivals Bear Stearns, Lehman Brothers and Morgan Stanley may have done. They release earnings in the next few days. That means none of the current crop will reflect the mini-rout that hit global markets just a few days later.

True, it wouldn't necessarily mean earnings would have been dented. Traders may well have profited from the increased volatility of the markets. The CBOE's Vix Index, which measures swings in financial markets, nearly doubled in the week after Goldman closed its books. But investors looking for such proof must wait for JPMorgan, Citigroup and Merrill Lynch to report their results next month.

Moreover, Goldman doesn't provide the best benchmark for the impact of the escalating woes of the U.S. subprime mortgage market. Unlike Morgan Stanley, Merrill Lynch and Bear Stearns, Goldman hasn't been snapping up lenders. Nor does it appear to have as much exposure to struggling home-loan providers like New Century, which counted Morgan Stanley as one of its big financial backers.

Of course, it's not just what Goldman didn't do wrong, but what it did right, that determined its brilliant first quarter. Goldman's fixed income, commodities and currency trading arm booked a record \$4.6 billion in revenue. Equities trading revenue hit a record \$2.1 billion, an increase of 75 percent from the preceding quarter. These helped defray a stinging decline in asset management fees, from \$739 million to \$90 million, largely a consequence of lacklustre performance at its \$10 billion Global Alpha hedge fund.

Add it all up, then, and it would be a stretch to view Goldman's latest results as a harbinger of even better times to come on Wall Street. More than likely, they may represent the high-water mark for the financial services industry.

Published on March 13, 2007

THE CURSE OF GOLDMAN ENVY

BY HUGO DIXON AND ANTONY CURRIE

Why did some banks get so badly scorched by the subprime debacle and others come through relatively untouched? What's the difference between Citigroup and JPMorgan? Morgan Stanley and Goldman Sachs? UBS and Deutsche Bank? Merrill Lynch and Lehman Brothers?

On the face of things, these companies may look quite similar to those they're paired together with. But Citi, Morgan Stanley, UBS and Merrill have among them written off \$65 billion so far due to the credit crisis. Meanwhile, JPMorgan, Goldman, Deutsche and Lehman have only racked up write-downs totalling around \$9 billion. The average share price performance of the first quartet last year was minus 36 percent. The latter group was only down 5.25 percent.

There are several reasons for this. One, undoubtedly, is luck. But something else explains a lot of the difference. The losers were infected by what one could call Goldman envy. The winners were more immune to the disease.

Goldman envy started to become a serious problem after the turn of the millennium, when that Wall Street firm started to pull away from the investment banking pack. Its profits per employee rose sharply as it deployed more of its own capital to big and sometimes complex bets – whether it was trading securities on its own account or investing in private equity.

Of course, it wasn't just Goldman that had competitors turning green. They also were agog over the burgeoning hedge funds and private equity groups that have been raking it in over the last few years and making ordinary investment bankers seem like poor relations. And many yearned for the juicy returns of Lehman Brothers' mortgage business.

One common response among those lagging behind has been to try to emulate the alpha males of the banking world – in particular by increasing their bets in the once-booming fixed income market.

Former Merrill boss Stan O’Neal would frequently berate his subordinates for not delivering Goldman-like results. Morgan Stanley’s ex-second-in-command Zoe Cruz was constantly using Goldman as the yardstick for her firm’s performance. And Citigroup executives described the megabank as a growth stock until just recently, putting its businesses under pressure to show commensurate earnings growth.

The snag is that mere desire doesn’t turn a chimpanzee into a gorilla. Building successful operations takes time. Part of Goldman’s success comes from the fact that its risk-taking approach – and the accompanying discipline of risk-management – derives in part from betting its employees’ own money.

But desire can drive reckless growth. Take Citi and Merrill. Five years ago, neither was a big player in underwriting subprime mortgage bonds and CDOs. But by 2006, they were at or near the top of the league tables for both markets.

The snag is that a bank is unlikely to manage things well when it’s expanding rapidly and doesn’t have experience. It may put the wrong people into place, not institute the right controls and implement the wrong incentive schemes.

The banks with the biggest problems seem to have made such mistakes. UBS, for example, quickly ramped up its residential mortgage business. But not because there was any strategic value in being in that market. Rather, it decided it wanted to bulk up in the hot securitization business, and trading and underwriting residential mortgages and CDOs was the easiest part of the market to enter.

So why were other banks relatively immune to Goldman envy? Well, Lehman had a big, lucrative mortgage lending and structuring business for almost a decade. So it didn’t need to engage in a break-neck game of catch-up. Deutsche arguably also had a more ingrained risk-taking culture.

Meanwhile, JPMorgan had more market-savvy leadership in Jamie Dimon than, say, Citi had in Chuck Prince.

All this suggests two lessons for the future. If you are a chimp, don't try to kid yourself that you're a gorilla. And, if you see a chimp pumping itself frantically with steroids, sell its stock.

Published on Jan. 19, 2008



SURVIVOR: WALL STREET - Lloyd Blankfein outlasted many of his counterparts through the financial crisis, including, from left to right, starting at top: Alan Schwartz of Bear Stearns; Marcel Ospel of UBS; Stan O'Neal of Merrill Lynch; Kerry Killinger of Washington Mutual; Ken Lewis of Bank of America; John Thain of Merrill Lynch; James Cayne of Bear Stearns; Chuck Prince of Citigroup; and Dick Fuld of Lehman Brothers.

REUTERS

CHAPTER 3

ROUGH RIDE

END OF AN ERA

BY JEFFREY GOLDFARB

The writing on the wall became all too clear for Goldman Sachs and Morgan Stanley. Surrender now, it read. And so they did. The last two big investment banks have traded in their Ferrari-like business models to become Buick-like bank holding companies. It's a symbolic end to a Wall Street that was both envied and despised for the wealth at its core.

Following the collapse of Bear Stearns, the demise of Lehman Brothers and the fire-sale of Merrill Lynch, quivering markets had turned their feral eyes on Morgan Stanley and Goldman Sachs. Just last week, both firms expressed confidence in their structures. Investors remained suitably sceptical as the financial crisis deepened. Morgan Stanley began serious merger talks while Goldman began contemplating its own fate more seriously.

By electing to become bank holding companies, both institutions are inviting closer scrutiny. Instead of being overseen by the Securities and Exchange Commission, a watchdog whose credibility has deteriorated, Goldman and Morgan Stanley will be watched by the Federal Reserve and Treasury's Office of the Comptroller of the Currency. The Federal Deposit Insurance Corp. will also have a say if both banks take on more customer deposits, as expected.

In return for agreeing to this greater oversight, Goldman and Morgan Stanley will be able to borrow short-term from the Fed on a permanent basis. The combination of more solid funding and stronger supervision should help boost short-term confidence, although some may fear the decisions were spurred by undisclosed but life-threatening liquidity problems.

Once the new regulation settles in, the former investment banks will probably have to rethink their balance sheets. The high Tier 1 capital ratios reported by U.S. brokers didn't correspond with crude measures of

leverage – about \$30 of debt for each \$1 of capital. The peak returns, in excess of 25 percent, support the case that these institutions have been too thinly capitalised.

The new bank holding companies can look forward to more solid capital bases, less risk and lower returns. How severe the transition and how long it will take are unclear. But in time, investors will also have to read the writing on the wall.

Published on Sept. 22, 2008

PAVED WITH GOLD, MAN

BY RICHARD BEALES



SWEET DEAL - More than 20 years after his investment in Salomon Brothers, Warren Buffett in the thick of the crisis bought \$5 billion of Goldman Sachs preferred stock yielding 10 percent.

REUTERS/Carlos Barria

In the credit boom, some said Warren Buffett had lost his touch. Now the Berkshire Hathaway boss has collected what looks like a canny investment in Goldman Sachs, Wall Street's strongest name. The folksy Sage of Omaha looks right back on form.

It's more than 20 years since Buffett dabbled with investing in Salomon Brothers, before being called on to run the struggling firm for a while. In the meantime, he has always had an eye for an investing bargain provided the operation concerned has what he calls a "moat" to keep competitors at bay. Despite being recently besieged, Goldman's reputation is still the nearest thing Wall Street has to that kind of defence.

Buffett is getting \$5 billion of Goldman preferred stock yielding 10 percent and warrants over \$5 billion of common stock at a strike price of \$115 a share, already in the money at Tuesday's \$125.05 close. Goldman also raised another \$5 billion in a public offering of equity announced early on Wednesday. If exercised, Buffett's warrants could convert into an 8.5 percent stake.

In hindsight, if Buffett was ever going to invest in Wall Street it had to be Goldman. Aside from the firm's industry-leading franchise and one of the few management teams in finance that still looks competent, he has a soft spot for Byron Trott, a Goldman banker, whom he has described as "the rare investment banker who puts himself in his client's shoes".

Goldman, meanwhile, has snatched from the jaws of defeat something that almost looks like a victory. The firm's shares were in free-fall for a time as the business model of Wall Street's remaining independent investment banks came under attack. After being propped up by the U.S. Treasury's rescue plan and then converting in a hurry to bank holding company status, it needed fresh capital. It's now got some, from about the only investor around whose endorsement could be worth more than his cash.

Coming hot on the heels of another \$5 billion Buffett deal last week – for Constellation Energy, which ran into financial-sector related trouble – it looks as if the legendary investor could finally be thinking things won't get much worse. Goldman may be a one-off transaction, but the sight of one of the world's canniest investors taking out his cheque book could well give a lift to other financial stocks, too.

Published on Sept. 24, 2008

A GIFT FROM GOLDMAN

BY ANTONY CURRIE

For once, rivals might be pleased Goldman Sachs took the lead. The Wall Street firm is the first bank to sell debt backed by the U.S. government under the Federal Deposit Insurance Corporation's debt guarantee programme. The \$5 billion deal – around twice what Goldman initially expected to raise – looks like a crowd pleaser. That's just what the market needs, even if it is still effectively a bailout.

Goldman wasn't facing a liquidity crisis any time soon, but should be glad to be able to tap the public bond market for the first time in seven months – and at a decent price, as the guarantee means the debt is rated triple-A. After adding in the one percentage point fee for using the programme, Goldman is paying 4.25 percent all-in – roughly half the yield its existing bonds are trading at in the secondary market. That's a better deal than UK banks are getting. They have to pay their government their median credit default swap premium for the past year plus a 50 basis point fee for their guarantees.

True, most of Goldman's regular bondholders won't touch the new paper with such a low coupon. But the deal should give them some comfort that their debt is safe, and may even convince them to buy more of the older bonds. Over time, that may bring those spreads down.

But the new debt certainly looks a boon to investors who usually buy U.S. mortgage agency and government debt. Goldman priced the deal to yield more than Fannie Mae and Freddie Mac bonds, even though the FDIC programme offers users the explicit backing of the U.S. government, something the agencies still don't have in writing.

Goldman appears to be overpaying by another metric, too: the deal is priced to yield 0.85 percentage points over mid-swaps, or the median rate at which double-A-rated banks lend to each other. Of Course, it's not unusual to offer a sweetener for a new deal from a new programme. That it succeeded should encourage other banks to follow suit, and potentially at better rates – and then start lending the money to get the economy moving. U.S. banks shouldn't get too cocky, though. After all, any success is down to Uncle Sam. Without U.S. taxpayers propping them up, most would be in bond market hell.

Published on Nov. 25, 2008

LONG-TERM GREEDY

BY ROB COX

The Panic of 2008 was notable for its absence of heroes. Unlike the crisis that hit American finance 101 years earlier with the collapse of the unregulated trust companies, there was no J.P. Morgan brandishing equal parts capital, moral suasion and authoritarian might to force the industry back on its feet.

In the current panic, villains have been identified in great abundance. That's made it foolhardy – even dangerous – for any Wall Street leader to poke his head above the parapet to defend the financial industry while calling for the eradication of its excesses. Now, though, Lloyd Blankfein, the chief executive of Goldman Sachs, appears to be doing just that.

Along with Jamie Dimon - who now runs the company Morgan founded – and, across the Atlantic, Deutsche Bank's Josef Ackermann, Blankfein is emerging as an influential voice shaping Wall Street's future.

Look no further than the speech he gave on Tuesday in Washington. In the face of taxpaying hecklers unfurling a banner beside him calling for their money back, Blankfein exhibited the contrition much of his industry has arrogantly avoided. After his detractors were escorted away, Blankfein attempted to articulate their rage and even connect with it.

He acknowledged the shoddy risk management that had infected finance. He laid out the basic principles that should underpin bank compensation. He rightly criticised lawmakers' efforts to restrict visas for skilled foreign workers. Not for the first time, he robustly defended mark-to-market accounting. And he accepted that hedge fund and private equity firms may need to be more heavily regulated.

Along the way, he sounded a good bit more statesmanlike than, say, Wells Fargo's chairman, who called government attempts to help banks "asinine".

Even so, Blankfein isn't an obvious leader of the swaggering Wall Street class. He's also extremely wealthy, making him a soft target for criticism from the hurting masses. Unlike the rotund Morgan, whose ever-present

cane and a bad case of rosacea gave him a frightful visage, Blankfein is a jocular, unassuming man with a frame that suggests the high school chess club rather than varsity lacrosse.

Goldman, too, is an unlikely breeding ground for an industry figurehead. It eschews the star system, instead emphasising a collegiate approach. And its role as a conveyor belt of talent to the previous U.S. administration – and to the board of accident-prone Citigroup – would seem to give it reason to keep its head down.

So Blankfein's tentative steps into the open may yet backfire. But as an experienced trader, he has surely calculated the risks and decided that it would be better to risk public embarrassment than hide in the bunker while his industry is dismantled.

Published on April 7, 2009

BOOM TIME

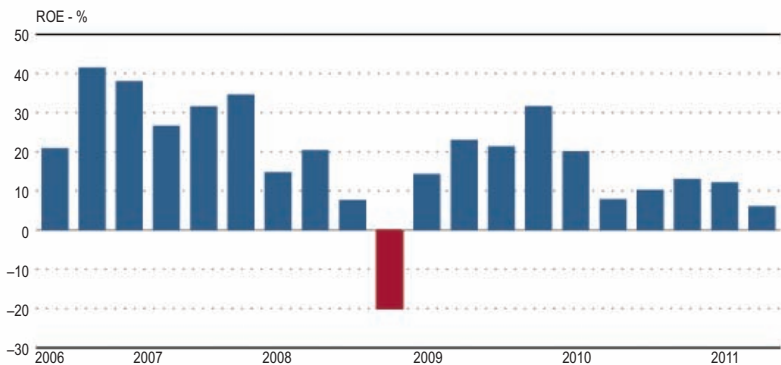
BY ANTONY CURRIE

Goldman Sachs has solidified its status as the winner of the credit crisis. The Wall Street firm had already demonstrated its relative success at managing risk ahead of and during the meltdown. Now it's at the vanguard of those cranking out healthy earnings again.

Some of Goldman's success was relatively easy to spot ahead of time: its fees as one of the lead underwriters in last quarter's boom in equity deals jumped an eye-popping 1433 percent to \$736 million. But most of the juice came from its trading desks. Both its equities and its fixed income, currency and commodities divisions posted record revenues – and, combined with principal investments, accounted for almost 80 percent of the firm's top line.

But that's not necessarily the result of Goldman ramping up its bets – aside from a jump in equities, the firm's value-at-risk stayed pretty flat in the second quarter. Rather, it's the fact that Goldman is one of the few firms left that is willing and able to put its own capital at stake, be it for clients or its own book. Rival Morgan Stanley, for example, nixed much of its risk-taking businesses at the end of last year.

Goldman's quarterly return on equity



Source: Thomson Reuters

That means Goldman is better placed to take advantage of the kind of activity that characterised the three months to the end of June: rallies in equity, debt and mortgage markets made perfect fodder for the Goldman money machine, especially with spreads in many instruments still wide compared to the days of the boom.

The question is whether Goldman can maintain such a heady performance. The firm is operating with leverage of 14.2 times shareholders' equity – almost half its peak in the first quarter of 2008. That's fine as long as spreads stay relatively wide. But as they narrow, Goldman is either going to have to win a lot more business, take a good deal more risk or ramp up its leverage. Otherwise, last quarter's 23 percent return on equity is going to be hard to replicate.

Published on July 14, 2009



CHAPTER 4

THE BACKLASH

SACHS, DRUBS AND ROCK 'N ROLL

BY ROB COX

The musician Dr. Hook once noted that there's nothing more thrilling than appearing on the cover of Rolling Stone. Goldman Sachs begs to differ. Though the investment bank is pictorially gazumped by the Jonas Brothers, the glossy advertises a 12-page manifesto on the firm's role in causing various plagues, from the housing crisis and oil price spikes to general famine.

At the risk of being branded by the screed's author one of the "thousand hacks out there willing to pimp Goldman's viewpoint", the arguments for the firm's evildoing aren't really new, they're porous and come in a package that diminishes their credibility.

But the investment bank is fair game. Goldman probably is a shade too influential; it does make tons of money – and its fair share of mistakes. Indeed, perhaps what's most surprising about the brouhaha is Goldman's dismissive response to it.

Goldman has often made money while others have suffered and it has benefited from decisions made by powerful people in high office, including its alumni. The stretch is in seeing the firm as some sort of organised cabal like the "Illuminati" of Da Vinci Code author Dan Brown's imaginings.

Sure, it's possible that beneath the Treasury there wends a secret passageway to a torch-lit altar where Hank Paulson, Bob Rubin, John Thain, Ed Liddy, Josh Bolten, Stephen Freidman, Bill Dudley, Mark Patterson, Gary Gensler, Neel Kashkari, Robert Steel and others don robes, drink bull's blood and paddle each other silly.

But the real problem is one of excessive groupthink. Goldman is a highly successful franchise that pays generously. This attracts very bright

BREAKINGVIEWS

people who are taught to embrace a shared business culture. They make money at an early age, which allows them to move on to less lucrative positions in government.

They take with them certain shared beliefs. Some may be benign: Capitalist economies are better than planned ones, etc. But others, such as the notion that markets can regulate themselves, have proven flawed.

Goldman's chief Lloyd Blankfein has expressed contrition for the firm's contributions to the bubble. The firm did not participate in the Rolling Stone article, and has since issued glib responses to it. But now that Goldman has made the cover, it may find addressing the issues head on – and acknowledging the downside of groupthink – is a more profitable and honest endeavour.

Published on July 1, 2009



FRIED CALAMARI – *Rolling Stone* magazine in 2009 branded Goldman Sachs a “great vampire squid wrapped around the face of humanity,” a moniker destined to stick. Pictured here is another type of cephalopod.

REUTERS/Ho New

GOLDEN STACKS

BY ROB COX AND ANTONY CURRIE

It would be easy for Goldman Sachs employees to forget there's a financial crisis still going on. The Wall Street firm posted stunning second-quarter earnings and set aside a record amount of treasure to pay staff. But Goldman's minions would be wise to tip their hats to the contributory role of the very visible hand of the taxpayer. Markets may still be rough, but the biggest remaining risk to Goldman's franchise could be a political and public backlash against the group's profits – and particularly its pay.

That's because the compensation numbers are staggering from almost every perspective. During one of the worst six-month periods in the history of finance, Goldman squirreled away \$11.36 billion in compensation and benefits – that's more acorns than it put aside in the first half of boom years 2006 and 2007. True, the pay is mostly just accrued, rather than paid, at this stage. And even during those earlier boom years, the firm failed to replicate its first-half performance in the second six months.

It's also true that on a per capita basis the numbers look a little less gilded than during the credit bubble. The first-half figures work out to around \$386,000 for six months' work averaged across every banker, trader, mailman and janitor at the firm. Since Goldman has 29,400 employees today, compensation per staffer is actually below the \$433,000 at which it peaked in the first half of 2006.

Goldman's corporate tax rate is running at a defensible 31 percent compared to last year's single digits. On top of that, its employees should be poised to hand over income taxes of some \$4 billion should their first-half accruals turn into hard cash. And with competition for people hotting up again on Wall Street – even from banks in much worse shape than Goldman – the firm does have to pay enough to keep the best and the brightest.

But the firm would be foolhardy to believe that these arguments will necessarily placate a restive public undergoing double-digit unemployment and politicians with ambitious and underfunded legislative priorities. And although Goldman showed a steely willingness to extend and manage risk

through turbulent markets while many rivals did not or could not, it is hard to imagine the firm doing so well without the extraordinary lifelines extended by the government, at taxpayers' expense, to Wall Street at large. Goldman boss Lloyd Blankfein has been notably contrite and appreciative in his public remarks on this matter. It remains to be seen whether that's enough to head off Congressional ire.

Published on July 14, 2009



BENJAMIN BLANKFEIN – *No firm's employees were better rewarded in the good times than Goldman's, including Lloyd Blankfein, who took home a \$68 million bonus in 2007.*
REUTERS/Lee Jae Won

MANNA FROM OBAMA

BY ANTONY CURRIE

Goldman Sachs is showing some humility. In response to mounting pressure from the White House and Main Street for Wall Street to curb compensation, the firm has set aside 35.8 percent of revenue to pay its staff. That's a record low ratio in a year of record earnings – the latter a feat the firm was at pains not to highlight. Though further financial reforms could sully things, Goldman's shareholders are for the moment reaping most of the rewards from this populist movement.

That's not to say employees are faring badly. They're still pocketing an average of \$500,000 each. That's nearly a fifth less than they would have received had Goldman set compensation at the same level as its previous record year in 2007. But since the bulk of their bonuses are being paid in stock, what's good for shareholders should ultimately be good for Goldman's workers too.

The bigger loser, then, may be the taxman. Bonuses, in the United States at least, are taxed at as much as 38 percent, higher than the 32.5 percent that Goldman paid on its 2009 earnings. All in, that means something like \$300 million less is going into state coffers – and possibly even less than that since bonus tax rates are higher in other countries, not least the UK, which has imposed a special levy on financial firms.

Charity gets a boost, of course: the firm donated \$500 million of its bonus pool to its in-house fund Goldman Sachs Gives, with partners taking the greater proportional hit to their compensation. But shareholders are the big winners. Reducing compensation boosted earnings by some \$2 billion after tax.

Granted, with no sign of either a dividend increase or a share buyback, the firm's owners won't get the extra cash in their hands. But, in theory, it's good news for the stock price, which jumped 122 percent last year. And as a fillip to retained capital it further strengthens Goldman's book value, its balance sheet and its wherewithal to grow the business – legislation allowing.

Of course, the White House's latest proposals to rein in the financial sector may well undermine this. Details on President Obama's desire to limit banks' size and the scope of their businesses are exceptionally vague; deciphering whether a prop trading desk, hedge fund or private equity fund owned by a bank serves customers or not, for example, is no straightforward task. But even watered down, such a plan could whack Goldman's earnings. Shareholders may want to indefinitely defer their thanks to Obama for the bonus break.

Published on Jan. 21, 2010

FILL IN THE BLANKFEIN

BY JEFFREY GOLDFARB

No one will ever mistake Lloyd Blankfein for a pauper. But compared to his equals on Wall Street, the Goldman Sachs chief executive is looking downright ascetic.

The fill-in-the-Blankfein bonus guessing game ended with a seven-digit figure instead of the \$100 million rumored payout. Goldman's board awarded Blankfein and his fellow top brass \$9 million each in restricted stock units for their work in 2009. The units don't start converting into regular shares until 2011 and can't be sold until 2015. Just as significantly, there's no cash in the mix.

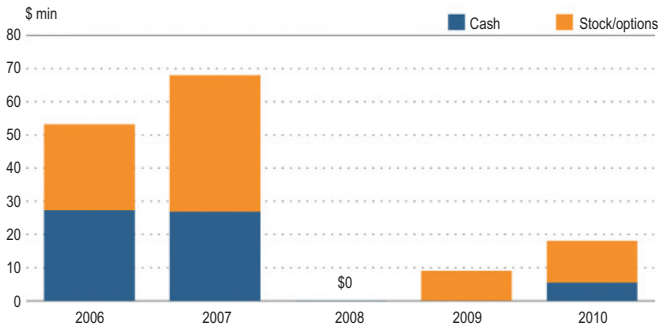
While it's a lot of money by any normal standard, the Goldman boss looks relatively underpaid by some measures. Add in his \$600,000 salary and he's still making less than many of his own employees, below the average pay of an S&P 500 company chief executive in 2008 (the latest year for which data are available) and seven times less than the 2007 version of himself when he delivered equally eye-popping shareholder returns and took home \$68 million.

Slice it another way and the relative austerity remains. Jamie Dimon is receiving \$16 million in stock and options – and the JPMorgan boss delivered an 8 percent return on equity last year compared to Goldman's 23 percent. Morgan Stanley's new chief James Gorman stands to get a nearly identical payday to Blankfein even though his firm lost money in 2009. Even the bosses of busted financial institutions like AIG and GMAC got approval from President Obama's pay czar to be paid more than Blankfein.

The calculation in paying Blankfein less than he arguably deserved is that the board can deflect the criticism – accompanied by potentially punitive legislation – that its chief profited unduly on the back of taxpayer support. Yet Goldman itself doesn't seem fully convinced its comparative parsimony will be sufficient to quell the torch and pitchfork crowd. It saved the most anticipated news on Wall Street for a Friday evening.

Published on Feb. 6, 2010

Lloyd Blankfein's annual bonuses



Note: Bonus does not include salary, pensions, supplemental benefits
Source: Thomson Reuters

Reuters graphic/Van Tsui

FIRST STEP: ADMISSION

BY CHRISTOPHER HUGHES

Even the mighty Goldman Sachs makes mistakes. The Wall Street bank's decision to help Greece keep some of its debts hidden from public view in 2001 was one of them.

The transaction allowed the Greek government to present accounts which understated the state's liabilities by 1.6 percent of GDP.

The arrangement was not illegal, not against any regulations and was approved by Europe's statistical authorities. Still, helping a client lessen the transparency of its finances is ethically questionable. For its own sake, Goldman should just admit that the firm compromised the principles it is supposed to hold dear.

At the time, it may have seemed that the deal's goal, comforting Greece's fellow members of the euro zone, justified the means. In retrospect, though, it's hard to reconcile such financial alchemy with Goldman's expectation that its people comply fully with the "letter and spirit of the laws, rules and ethical principles that govern us".

There are, to be sure, mitigating factors. Goldman, which carefully considers the ethical and reputational risks of individual transactions, wasn't alone. Other banks helped governments take advantage of the European Union's weak fiscal governance. But Goldman regards itself as the global standard setter, demanding "high" ethical standards of its people, and eschewing the practices of the crowd.

Similarly, it can be argued that Goldman followed its overarching business principle that client interests always come first. And it certainly remained faithful to another tenet: that the firm should strive for creativity. It's also true there have been almost no complaints about this transaction until now.

Such considerations help explain why a senior Goldman executive said the Greek deal was not inappropriate – and why Goldman posted a dry explanation of the deal on its own website. That's all in tune with Goldman's general post-crisis message: We have done little wrong and many of the attacks directed at us are sour grapes.

But outsiders are much more critical – a fact that Goldman ignores at its peril. Even Ben Bernanke, the generally pro-Wall Street Federal Reserve chairman, has raised questions about Goldman's role in the Greek pastichio.

Humility may not come easily to Goldman, but it can be the most creative, and effective, response to criticism. Goldman's longer-term interests would be best served by admitting that on this occasion dedication to client service and creativity got the better of its judgment, something it won't let happen again.

Such an admission wouldn't reflect well on Goldman's client, the Greek government. But the fact that Greece fudged its finances is hardly under debate. At the very least, Goldman could admit that it should, with hindsight, have advised against the deal.

Published on Feb. 26, 2010

TIGHTROPE WALKER

BY ANTONY CURRIE

Just what Lloyd Blankfein would write in his annual letter to shareholders this year has been the source of almost as much market speculation as the size of his 2009 bonus. Would the Goldman Sachs boss adopt a contrite tone, or come out swinging? In fact, Blankfein seems to have pulled off a delicate balancing act between the two.

The Goldman boss could not afford to ignore the role the United States and other governments played in putting the financial markets back on their feet. So he credits them early and often – six times on the first page. Compare that to JPMorgan’s Jamie Dimon, whose first nod to Washington comes 26 pages into his substantial tome.

Blankfein also had to go on the defensive. He dedicates almost a third of his letter to rebutting accusations that Goldman acted improperly in its dealings with American International Group and in using short positions to reduce its mortgage risk as the crisis unfolded. And he spends another good chunk portraying Goldman as a financial force for good: that its trading division acts almost exclusively for clients, that it is a major financier for governments and non-profits alike and that its principal investments division helped raise capital for companies when other sources dried up in the crisis.

The letter is clearly aimed more at his critics in Washington and elsewhere than at his own investors. What it lacks, though, is the kind of chutzpah that Dimon brings to the table: even while thanking the government for its role in the crisis, the JPMorgan chief uses his letter to remind his shareholders that he didn’t like the backlash that ensued – and that his firm didn’t need the money anyway. He even devotes three pages to his suggestions for regulatory reform.

Of course, Goldman has become the proxy for all attacks on the role financial firms played in the crisis, so its boss does not enjoy the same latitude as Dimon. Nor are Blankfein’s words likely to silence his critics – short of closing the bank down, nothing will. His letter underscores the jam Goldman’s in. But it is, at least, a spirited defense.

Published on April 7, 2010

IT'S NOT EASY AT THE TOP

BY EDWARD HADAS

Lloyd Blankfein and Pope Benedict XVI have a few things in common these days. The chief executive of Goldman Sachs and the supreme pontiff of the Roman Catholic Church serve different masters – mammon and God respectively – but both are embattled leaders of institutions that used to be considered global leaders in their respective fields.

The two organisations' recent failings are in no way comparable – Goldman's being merely a matter of money while Rome's involve the shocking abuse of children. But the two chiefs' damage limitation exercises are taking similar paths. Both pope and banker have offered mea culpas for past errors and promised to enforce tough new standards. Friends say they have done more than enough.

Their enemies scoff. People at the top of such corrupt institutions are too entrenched to lead the necessary reforms. Didn't Blankfein say he was doing "God's work"? Didn't the pope dismiss his critics as engaging in "idle chatter"? Resignations would be a start, but many opponents think only radical solutions will do: new dogma for Catholics and dismemberment for Goldman. The rhetorical heat makes it hard to separate legitimate grievances from simple hatred.

Still, investment banking has survived wars, depressions and forced dismantling. And the ancient Catholic Church is still going reasonably strong despite Galileo, indulgence scams and the disappearance of the Papal States. Goldman may end up with less proprietary trading and lower pay scales, but it will probably survive. And the Catholic Church is a pretty good emerging market play, even if it were to lose some clout in its traditional homelands.

Despite the serious lapses among his flock, the theologian in the Vatican probably still has more friends than the former trader on Wall Street. But both men seem stuck in unusually challenging valleys of tears. To get through with minimal damage to the institutions they head, they need to mix bold action with humility. Blankfein is probably more practiced at the first and Benedict at the second. With a bit of mix-and-match, each may well succeed in keeping even implacable enemies at bay.

Published on April 9, 2010



REUTERS

CHAPTER 5

IN THE DOCK

BURNING AMBITION

BY ANTONY CURRIE

The Securities and Exchange Commission has lit a fire under all the smoke billowing around Goldman Sachs. The bank has become the popular totem for public anger over Wall Street greed. But so far Goldman has been embroiled in little more than a war of words. Now the SEC has accused Goldman and one of its employees of securities fraud related to how they structured and sold a synthetic collateralized debt obligation backed by subprime mortgages in 2007. The stakes couldn't be higher.

After all, despite all the smoke about Goldman's conflicts of interest, clients have hardly run from the building. The firm still sits atop, or near it, in many investment banking and stock sales businesses. And in 2009 it traded with 6,000 customers, a third more than three years before. That helped the firm make a whopping \$13.4 billion last year.

It's unlikely all those clients consider Goldman to be a paragon of virtue. Many probably even scoffed a bit at Chief Executive Lloyd Blankfein's insistence in last week's letter to shareholders that the firm only acts in the interests of its customers.

But the SEC allegations, which Goldman disputes, lay out a scenario customers may have feared: some clients are more important to Goldman than others, and those without the requisite status can be burned. The regulator also dragged in the most famous beneficiary of the mortgage meltdown, Paulson & Co. The hedge fund made \$1 billion shorting the trade the SEC outlines, the same amount lost by investors who bought the bonds. Paulson isn't charged with anything - but the case revolves around allegations that Goldman misrepresented the role Paulson played, and obscured it from investors.

BREAKINGVIEWS

The SEC's flimsy reputation may be at stake over the case, but Goldman's even more so. The charges alone spooked investors, who wiped out more than \$10 billion of the bank's equity on Friday morning. They could scare off some clients too. Some European authorities shunned working with Citigroup after its "Dr Evil" trade in government securities came to light in 2004. And Orange County, California, swore off working with Merrill Lynch – even years after the bank settled charges it sold the region's treasurer too-risky investments.

Goldman may eventually be exonerated. But containing the fire lit by the SEC will be an exhausting endeavor. The bank will be hoping any damage can be contained to the offending product – which of course smoldered long ago.

Published on April 16, 2010

BOYS IN A BUBBLE

BY JEFFREY GOLDFARB

The performance of Goldman Sachs executives, past and present, in the U.S. Congress shows one bubble has yet to pop. That's the bubble Wall Street and those close to it inhabit. Sure, the whole Senate subcommittee hearing on Tuesday was largely theater. But one thing seemed clear: Goldman is still out of touch with the world beyond its immediate orbit.

At least through the first five hours of the hearing, it was more about sound-bites than substance. The grandstanding from senators included an expletive-riddled grilling by the panel's chairman, Carl Levin, quoting Goldman emails. But the bankers parsed their words carefully. They were well-prepared by lawyers, and each had a cinderblock-sized binder of documents in front of them that seemed at times as hard to navigate as a prospectus for a collateralized debt obligation.

Their cautious responses left Goldman still looking as though it cares more about itself than its customers or anyone else. While dodging some questions, the executives variously said they had no regrets or that they didn't think they or their firm contributed to the collapse of the mortgage market or the wider financial system.

Goldman's problem is this message simply won't play on Main Street – and may seem inadequate these days even to some clients. Sure, it's never easy to appreciate the perceptions of those looking in from the outside. And Goldman has a litany of reasons to think pretty highly of itself, from its profitability to its blue-chip reputation and its influential network of alumni.

In recent days, the firm has also seen Blackstone boss Steve Schwarzman pledge to remain a loyal client and Thomson Reuters Chief Executive Tom Glocer, who counts Goldman and others on Wall Street as customers, writing on his blog that it seemed “too easy and too politically expedient to jump on this bandwagon” of anti-Goldman sentiment.

Of course Goldman deserves the chance to defend itself. And the misleading presentation of information by legislators is no better than Goldman's own self-serving spin. But the firm's capable financial whizzes have capitalized on any number of bubbles popping. There may yet be value to be had by deflating the one in which they seem to remain enveloped.

Published on April 27, 2010



BLAME GAME – Goldman executives said during a 2010 congressional hearing they didn't think they contributed to the collapse of the mortgage market or the wider financial system. Among those who testified were, from left to right: Daniel Sparks, Josh Birnbaum, Michael Swenson and Fabrice Tourre. REUTERS/Jim Young

PINK LLOYD

BY ROB COX

Goldman Sachs could use a non-executive chairman right about now. Four years ago, the investment bank decided against separating the roles of chairman and chief executive and instead gave both jobs to Lloyd Blankfein. But now, as Goldman and its boss find themselves in the crosshairs of legislators, regulators and the public, that sure looks like a lost opportunity. It's not too late, though, for the firm to make the change.

Not that putting Blankfein in charge was a mistake. There's a reason Goldman shareholders, including Warren Buffett – who defended Blankfein at Berkshire Hathaway's annual meeting at the weekend – want him in charge. Under his leadership Goldman earned record profits during the boom and avoided the missteps that brought down Bear Stearns and Lehman Brothers, and nearly ruined other rivals in the bust.

Of course, some of the ways in which Goldman did this are now the source of controversy and a Securities and Exchange Commission accusation of fraud.

The trouble is the qualities that make an excellent manager of a global securities firm do not necessarily work as effectively in the fishbowl of American, and global, public opinion. Blankfein has a good nose for money and talented traders and bankers. And in private he's funny and surprisingly self-effacing for the leader of Wall Street's richest firm.

But these attributes may be of little service in handling politicians and taxpayers in an economic downturn who have little inclination to understand the nuances of banker compensation or details of synthetic capital markets. Meantime, Blankfein's sense of humor (“doing God's work”) has come across as glib rather than thoughtful.

Here's where having a non-executive chairman could help. For one, the chairman could ideally provide some air cover for the chief executive. A statesmanlike figure, with strong political and diplomatic skills, would also help deflect some of the glare that has been laser-focused on Blankfein, allowing him more time to run the company.



REUTERS

That, to some degree, has been the experience of Citi, whose chief executive Vikram Pandit struggled with his own public persona a year ago. Naming politically-savvy Richard Parsons as chairman just over a year ago helped take the heat off Pandit. Judging by his last appearance in Congress, Pandit used that time to hone his speaking skills.

There are other good, corporate governance arguments to separate the chairman and CEO roles. That's why increasing numbers of U.S. companies are doing so, including Goldman rivals Bank of America and Morgan Stanley.

True, making a change now might give the impression that Goldman's board had lost faith in its chief. But with the pressure increasing on the firm, it could also be the best way to keep Blankfein where he belongs: running Goldman Sachs.

Published on May 4, 2010

REPUTATION BY COMMITTEE

BY ANTONY CURRIE

There doesn't seem to be much Goldman Sachs boss Lloyd Blankfein can do to silence his critics these days. The Wall Street firm's decision to set up a business standards committee is a smart idea that could help shore up its reputation – and improve its relations with clients – but only if Blankfein gives the new watchdog real teeth.

The clearest way to do that is to ensure that the committee's members have the power to say no to traders focused on making a fast buck that could damage the reputation of the franchise in the future. Blankfein reckons Goldman already does that, telling senators in April that the firm believes in rewarding "saying no as much as saying yes."

To prove that, the committee will need to indulge in a modicum of transparency. That could mean appointing independent outsiders as members. At the very least it requires making public the standards by which the firm's bankers and traders will be judged. That won't be easy for Wall Street's most cloistered parish. But without it, the committee will be little more than an empty PR exercise.

At stake is Goldman's status as the trusted adviser that gets the first call from corporate chieftains, governments and investors the world over. Up to now, Blankfein says the business has held up well. But talk that AIG is dumping Goldman as its restructuring advisor is not a good sign - even if as a ward of the government it is easy to see why the insurer would be more sensitive to Goldman's reputational issues than other firms.

The risk is that the longer Goldman remains under the microscope, the greater the chance that corporate clients will think like an AIG. A thoughtfully constructed committee tasked with "rigorous self-examination" of the firm's business would be one way to ensure that Goldman's legendary focus on what legendary senior partner Gus Levy called "long-term greedy" can continue to pay off.

Published on May 7, 2010

CONTENTS MAY SETTLE

BY ANTONY CURRIE

Neither Goldman Sachs nor the Securities and Exchange Commission comes out of their slugfest looking pretty. But in settling fraud charges without admitting guilt, the Wall Street firm has beaten the regulator on points, despite a record penalty. That doesn't mean Goldman can leave the ring just yet, though. It has conceded that its disclosure on the mortgage collateralized debt obligation at the heart of the SEC's case was inadequate. That's something that could rebound on Goldman and the rest of the finance industry.

Right now, Goldman has to stump up \$550 million, the hardest penalty punch the SEC has ever landed on a single Wall Street target. But the firm should be able to roll with it. The settlement represents just 3.4 percent of its compensation bill last year, or the equivalent of the average annual compensation for just 1,100 of its 32,500 employees. That aside, three months in the regulatory sin bin may have taken the edge off Goldman's appeal with clients - but that's not clear yet.

Meanwhile settling makes the SEC's original crusading bombast look overdone. In making its initial accusation of securities fraud the regulator seemed to be targeting an even more punishing financial blow and at least the removal of Goldman's chief executive, Lloyd Blankfein. But the watchdog has elicited only the admission that the investment bank's marketing materials were incomplete, along with relatively modest internal changes, some of which were already in the works.

Announcing the settlement on the day the U.S. Senate finally passed the Dodd-Frank regulatory reform bill also looks a tad convenient, though the SEC denies any connection. Rightly or wrongly, the enforcement of the case now comes over as opportunistic all along – from throwing down the fraud charges just days before Goldman's first-quarter earnings at a time when reform efforts needed a boost, to settling them days before the firm's next quarterly report with reform legislation on its way to the president's desk.

All that said, landing one well-placed blow on disclosure could leave a longer-lasting scar on Wall Street. Investors who feel they're wrongly out of pocket from buying complex securities from Wall Street are bound to pounce on that admission and file lawsuits of their own. That could leave Goldman and its rivals under attack for some time to come.

Published on July 16, 2010

CHAPTER 6

MIXED MESSAGES

REPUTATIONAL VOLATILITY

BY ROB COX



FRIEND INDEED – Facebook founder Mark Zuckerberg displaced Lloyd Blankfein atop Vanity Fair's 2010 list of the most influential people. Goldman would later be hired to manage a controversial \$1.5 billion private placement for Facebook.
 REUTERS/Norbert von der Groeben

Teflon financial institutions in America and its leader, Blankfein, was the king of Wall Street. Hence his arrival at the top of Vanity Fair's list. That very success, however, helped sow the seeds of Goldman's annus horribilis.

Reputations aren't all that different from stock market valuations. Very often people are overrated, fail to live up to expectations and decline in the eyes of their peers. Perhaps they then become underrated, like cheap stocks, their intrinsic value under-appreciated by the masses. And so it goes for Lloyd Blankfein.

The Goldman Sachs Chief Executive just went from the cultural equivalent of a "strong buy" investment rating to a "sell" on Vanity Fair magazine's list of the 100 most influential people, dubbed "The New Establishment." Blankfein did not merely cede the top slot to Facebook founder Mark Zuckerberg - he fell to 100.

Both ratings probably miss the mark. A year ago Goldman appeared to be one of the few

The firm was pilloried in the press and by politicians for making too much money out of government bailouts of the financial sector. Its lack of a contrite response, Blankfein's coy public remarks and, latterly, a Securities and Exchange Commission fraud allegation – subsequently settled – badly tarnished the Goldman boss's crown.

So, like a stock price, Blankfein's rating has swung from bubble to beaten-up territory. Where does it go from here? From Goldman's perspective, the best outcome would actually be to disappear entirely from the list. After its PR nightmares, the less written about the firm – still run a bit like a private partnership – the better.

But don't count on it. One reason, ironically, is Facebook. Social networkers have so many options that Zuckerberg probably isn't really top of the heap, as Vanity Fair has ranked him. But a Facebook IPO – expected in the next year – will undoubtedly anoint investment banking monarchs. And there's a better than 50-50 chance that a prominent manager of the floatation will be – you guessed it – Goldman. Running the Facebook IPO would help Blankfein's firm top the IPO league tables. Unlike the Vanity Fair list, these rank money, the true measure of Wall Street.

Published on Sept. 2, 2010

OFF THE BOIL

BY ANTONY CURRIE



TRADER JOES – *Goldman traders traditionally boast a sparkling reputation, but in the last few years, amid the market turmoil, their performance has been more up and down.*
REUTERS/Brendan McDermid

revenue was almost flat, and JPMorgan's actually improved slightly after adjusting for marking its liabilities to market value. Traders at a resurgent Bank of America raked in more than 50 percent more revenue than in the previous three months and crowed about logging a perfect record, meaning no trading losses on any day in the quarter.

It's the second quarter in a row that Goldman's traders have slipped. Previously, the firm's equities unit took a hit after being on the wrong side of the volatility trade. That helped push the firm's second-quarter return on equity down to 9.5 percent, excluding the one-off UK bonus tax and the cost of settling a lawsuit with the Securities and Exchange Commission. This time, the firm only managed to improve to a humdrum 10.3 percent

Goldman Sachs is coming down to earth with a bit of a bump. Sure, the Wall Street giant's third-quarter earnings of \$1.9 billion handily beat analysts' expectations. That's good news in any quarter, and especially after talk of a summer slowdown. But Goldman's results usually lead the pack. Not this time.

Take the firm's market-leading franchise in fixed income, currency and commodities trading, where revenue fell 14 percent from the second quarter, or around 10 percent once accounting for losses taken marking up the value of its own debt.

That's not bad. But it's the biggest drop of the major firms that have reported so far. Citigroup's FICC

return. Compare that to JPMorgan: its investment bank clocked 13 percent, and its asset-management unit returned 25 percent.

Goldman's showing is hardly disastrous. Its investment bankers enjoyed a decent summer, with underwriting revenue jumping 40 percent and M&A work bringing in 5 percent more lucre. Equities trading recovered somewhat, and at \$3.77 billion Goldman's FICC revenue is still the largest in its peer group - just.

And the relative underperformance of the bank's traders of late may just be a blip in their otherwise enviable record. But for once these sometimes omniscient-seeming masters of the financial universe are looking much more like mere mortals.

Published on Oct. 19, 2010

AUTUMN GAMES

BY JEFFREY GOLDFARB

Achieving partner status at Goldman Sachs is like winning the decathlon of the Olympics of banking. And the degree of difficulty in the latest biannual competition, which anointed 110 new medal winners, rated higher than ever. This crop has not only survived two years of financial mayhem but also Goldman's special publicity and regulatory hell. That means achieving Elite Status membership now warrants an extra point of pride. Yet these victors may lay claim to lesser spoils.

Entering the Goldman inner circle is about more than just bragging rights. It may not come with quite the same influence it did in the 130 years leading up to the firm's conversion from private partnership to public company in 1999. The salary hasn't improved either; it's the same \$600,000 it was back at the time of the IPO. But partnership still provides plenty of other perks, not least of which is access to a slice of a special bonus pool above and beyond what is doled out to the bank's lesser mortals.

It hasn't been getting any easier to impress the judges. Though Goldman has in recent history maintained the partnership ranks at a little less than 2

percent of its full-time staff, this time around roughly one of out every 240 of them was added to those who wear the garland, bringing the count to 470. When the good times rolled four years ago, closer to one in 190 were brought into the fold.

Of course, Louis Vuitton bags and Ferretti yachts can't be paid for in pride. And there could be less lucre available to the Goldman Class of 2011. The firm is revamping its business model to adjust to a brave new post-crisis world. It's not that Goldman hasn't adapted to change well in the past, but fewer bets with the house's money, greater regulation, lower leverage and higher capital requirements all will put the model to a more serious test.

They have already taken a toll. Goldman's 24 percent return on tangible common equity over the past 11 years is moving in the wrong direction, slipping to less than half that over the last two quarters. And payouts to the privileged club are more highly geared to the firm's performance than for other staff. Those who achieve Goldman partner status may still be faster, higher, stronger – just not necessarily richer.

Published on Nov. 17, 2010

FOLLOW THE LAGGARD

BY ROB COX

Wall Street rivals usually follow where Goldman Sachs leads. It is unlikely to be any different when the findings of Goldman's Business Standards Committee become public early next year. But on one important point Goldman lags some big competitors – the separation of the chief executive and chairman jobs. Now it has a chance to catch up.

Since May, the bank has been conducting the financial industry version of group psychoanalysis. The standards group chaired by veteran partners Gerald Corrigan and Michael Evans is scrubbing the bank's business practices to "reinforce the firm's client focus" and improve transparency.

The firm is examining, among other things, how it manages conflicts between its own activities and those of customers; how it discloses what it does; what responsibilities it has to clients; and, critically, how to inculcate a sense of professional ethics in its employees.

The results aren't just highly anticipated among Goldman's 35,400 employees. Every firm on Wall Street will pore over them. The firm's public image may have been tarnished by reams of bad press and a Securities and Exchange Commission suit – since settled – alleging that the firm shortchanged some of its customers. But the bank is still considered the gold standard among its peers.

So if Goldman decides, say, to exit a business because it feels it creates conflicts of interest with clients, other banks will feel pressure to do the same – or risk expending considerable energy explaining to clients why they are different.

What's not obviously on the business standards agenda, though, is Goldman's own governance. This seems odd given the intensity of the soul-searching going at the firm. Goldman's financial performance has not suffered in any obvious way from having Lloyd Blankfein hold both the CEO and chairman roles.

But Goldman, and specifically Blankfein, did take quite a beating in the public arena of late. Though some of the opprobrium was undeserved, the experience should have underlined the merits of separating duties at the top of the firm. The skills that brought Blankfein the top job at a competitive securities firm that consciously avoids the retail end of the market aren't necessarily the same ones that are effective in the unwanted glare of political and Main Street scrutiny.

Having a seasoned chairman would have given the firm someone to navigate the shifting political and regulatory tides while Blankfein focused on the firm's operations and employees and, most importantly, on its big corporate and institutional customers. Executives at banks that did separate the top two jobs – a list that includes Citigroup, Morgan Stanley and Bank of America – say the move paid off at the height of the recent crisis and in efforts to shape the regulatory reform bill passed by Congress.

Of course, a division of responsibilities is not a substitute for strong leadership. A chairman who does a poor job of interfacing with politicians or the media won't be able to offer a chief executive much cover. And it's critical that the chairman and CEO have a consistent vision for the company, a good working relationship, and complementary skills.

That's not always the case, as British energy giant BP amply illustrated during the months it spent trying to stanch the flow of oil – and attendant negative press coverage – from its leaking Gulf of Mexico well. Carl-Henric Svanberg earned the sobriquet of "invisible chairman" for his low profile during the fiasco. And when the Swedish native did speak publicly, he did little to help gaffe-prone chief executive Tony Hayward, famously referring to the oil leak's victims in the Gulf as "the small people."

Blankfein is no Hayward. He has the confidence of shareholders, his board and his staff, and he survived antagonistic political hearings in much better shape than Hayward, if not completely unscathed. Having steered Goldman through the financial crisis and the annus horribilis the bank's image endured in 2010, his job looks secure.

But that makes the timing right for a change in governance. The Business Standards Committee itself offers one possible candidate to step in

alongside Blankfein in the form of Corrigan, a former president of the New York Federal Reserve. By proposing to add a chairman now, Goldman would avoid the common stigma of separating the two top jobs at a time of weakness. Doing so from a position of strength would set another example for its rivals.

Published on Dec. 14, 2010

MEET, SAY, LOVE

BY JEFFREY GOLDFARB

Goldman Sachs' spiritual journey mostly leads the firm back to where it started. A highly anticipated report from the firm's Business Standards Committee will disappoint anyone expecting wholesale reform. Its 39 recommendations mainly reaffirm the business principles that guide the bank. But along with added disclosure and heightened compliance, Goldman may strike a new balance with its most important constituency: clients.

The eight-month soul-searching exercise began after Goldman's financial success through the crisis gave way to a lambasting in the press, a public mauling in Congress and a \$550 million regulatory settlement. So the anticipation was that Goldman might find some new religion. That's not quite what emerges from the 63-page hymnal.

Rather, the advice consists largely of tweaks to internal practices and procedures. For example, the committee recommends Goldman employees be judged not just on the numbers but also on how well they represent the franchise and build client relationships. It advocates the creation of a matrix to determine which products are suitable for which customers. And complex transactions will require additional reviews and approvals.

True, much of this sounds like MBA mumbo jumbo. But it's a fair bet Goldman employees will read the document closely – and think twice about potential conflicts and the interests of clients as a result. To further ensure they do, the firm is implementing a training initiative built around the recommendations for senior staff, led by boss Lloyd Blankfein. The overriding message is clear: Goldman lives and dies by its reputation.

And on the margins, Goldman will open up a bit. The bank will report revenue from four business groups instead of three in a change that will see its proprietary investments distinguished from those of clients.

Goldman's balance sheet will lay out assets by division, including information on liquidity and client margin lending positions. These disclosures could be cathartic for Goldman and potentially reassuring for investors.

But the main effect will be to give clients a stronger sense that they come first. Without that trust, the firm's ability to wrest fees from them is imperiled. In that sense, this latest iteration shows Goldman is truly enlightened.

Published on Jan. 11, 2011

DON'T BECOME THE STORY

BY RICHARD BEALES

Perceptions about Goldman Sachs have shaped the reality of its Facebook fundraising. The Wall Street firm is now excluding U.S. investors from buying into the social network after media scrutiny made a private placement seem too public. Facebook invites attention - but Goldman does too these days. For all its focus on clients, the firm still has a blind spot about its own public image.

Getting hired by Facebook for a \$1.5 billion private placement was a coup for Goldman. But in hindsight, bankers took a chance on their ability to keep a lid on things. With Facebook easily the hottest Internet property and carrying a putative valuation of \$50 billion, it was always likely that reporters would unearth details. And that danger was surely multiplied by the association with Goldman.

The firm used to be the investment banker's investment bank - highly influential, but operating mostly under the radar. That started to change at the time of its IPO a little more than a decade ago, and attention rocketed during the financial crisis as Goldman and its alumni faced negative headlines and

often failed to explain themselves successfully. That spawned conspiracy theories, mostly far-fetched. But the firm has become a regular media target.

Goldman would have been on safe ground with Facebook had there been no leaks and even, probably, if the placement documents had reached the public domain in full. As it was, bitty and inaccurate revelations meant some potential investors might not be getting a full picture - and under U.S. private placement rules, Goldman couldn't pipe up to clarify. The decision not to sell the deal to U.S. investors was probably the right response.

This doesn't mean Facebook made a mistake by hiring Goldman. It looks as if Mark Zuckerberg's company will easily get all the investment dollars it wanted. But the episode suggests companies considering hiring Goldman - especially those hoping to do deals that break new ground or test existing rules - may need to weigh the firm's profile as a potential risk factor. Goldman, meanwhile, needs to realize it's no longer toiling away in the background. Recognizing that may help it one day regain a measure of obscurity.

Published Jan. 18, 2011

BABY STEPS

BY ANTONY CURRIE

Any extra disclosure that sheds light on the murky workings of Wall Street should be applauded. So Goldman Sachs deserves credit for adding some useful new data to its annual report. But the investment bank's flirtation with increased openness only goes so far.

Perhaps the most obvious overall improvement is in the way parts of the annual report are written. It won't win any prizes for flowing prose, but the sections on risk management, liquidity and other balance sheet issues have been infused with clearer language than usually can be found in regulatory filings.

On a more substantive note, Goldman has provided a more detailed breakdown of how it allocates assets to each of its business units. Institutional Client Services, for example, which houses the firm's client trading desks, accounts for \$364 billion, or just over a third of Goldman's



MODERN FINANCE – *Following a wide-ranging internal review, Goldman opted to provide more disclosure about capital allocation and its balance sheet, overseen by Chief Financial Officer David Viniar.*
 REUTERS/Yuri Gripas

\$911 billion in assets. Investing and Lending, meanwhile, where all loans and proprietary investments reside, takes up \$58 billion. Since Goldman also started revealing pre-tax income for its various business units earlier this year, investors can get a more detailed sense of returns on the firm's assets.

Goldman also now breaks out credit exposures by quality, region and industry. Last year, the bank increased its exposure to assets rated A or lower by 11 percent. It bumped up exposure to banks and other financial institutions by more than a quarter and its activities in the Americas by 14 percent. Meanwhile, governments and central banks were slightly out of favor at Goldman, as were Europe, the Middle East and Africa.

That's more detail than most rivals hand over. But Goldman could easily have gone further, for example by detailing how much capital and leverage it allocates to various businesses, especially trading. And while the firm does lay out some scenarios for liquidity stress tests that its Business Standards Committee report in January implied would be forthcoming, it offers less detail than the promise implied. No doubt it's a work in progress. But if Goldman is to maintain a financial divulgence lead, it will need to do more still.

Published on March 1, 2010

SILENCE IS GOLDMAN

BY ANTONY CURRIE

Goldman Sachs should take more credit for its failures. That's a bitter pill to swallow for a firm that prides itself on its wits. But being less clever than most people think is one of Goldman's best defenses against claims of engaging in mortgage shenanigans during the crisis.

Top brass, including Chief Executive Lloyd Blankfein, have argued the position before. They claim that while Goldman was net short in subprime mortgages in 2007, its overall housing book was closer to neutral that year – and lost \$1.7 billion in 2008. Yet only now does Goldman seem to be considering reinforcing the idea by disclosing specifics about some of the trades, almost two months after U.S. lawmakers bashed the firm. In a hulking report, Senator Carl Levin accused Goldman executives of exploiting clients, misleading his subcommittee and making money on a net short position in mortgages in 2007.

That was the time for Goldman to jump in with its version of events. The senators even served up some howlers, several times mistaking the firm's earnings for revenue and thus wildly overstating the impact of one mortgage desk's gains on the overall bottom line. Putting the spotlight on such a basic error may have added some weight to the claims now leaking out that the congressional report miscalculated its long and short mortgage positions.

Yet Goldman instead stuck with a terse unspecific response. Choosing not to pick a bigger fight with the nation's legislators probably seemed prudent at the time. But the Senate's allegations have since helped turn yet more attention onto the firm's activities as the housing market crashed – including a subpoena for still more information from Manhattan District Attorney Cyrus Vance.

Going on the offensive now makes the firm's executives look wrong-footed, harried and even a tad desperate. They might not have made many friends had they decided to talk up their losses and exposed the congressional math sooner. But silence hasn't helped either. The shares have steadily crept down toward book value amid fears of more costs growing out of

Levin's version of events. In a perverse way, the better Goldman had advertised its trading shortcomings of a few years ago, the better investors might feel today about the firm.

Published on June 6, 2011



CARL MARKS – After grilling Lloyd Blankfein and other Goldman executives, Senator Carl Levin, a Democrat from Michigan, accused them of exploiting clients and misleading his subcommittee. REUTERS/Jason Reed

CHAPTER 7

THE FUTURE

NOT WHAT PAUL WANTED

BY ROB COX

Goldman Sachs is lobbying to weaken limits on proprietary trading imposed by the Volcker Rule provision in last year's U.S. financial reform. But like most hastily-crafted legislation, the rule has unintended effects that are only now becoming apparent. One may make the business of managing private equity investments even more lucrative for the likes of Goldman.

That's hardly what Paul Volcker envisioned when the White House trotted him out amid a frenzy of anti-Wall Street sentiment in January 2010. The former Federal Reserve chairman said the rule would make banks safer by curtailing high-risk behavior, including investing in leveraged buyouts.



CASTING A PAUL – The Volcker Rule, named for former Fed Chairman Paul Volcker, may have some consequences he didn't intend when President Barack Obama trotted him out in January 2010 to discuss financial reform. REUTERS/Kevin Lamarque

The Dodd-Frank law stipulates that a bank's own money cannot comprise more than 3 percent of a private equity fund it manages, and that aggregated fund holdings cannot total more than 3 percent of its Tier 1 capital. For most banks, that's no big deal. Many got out of the buyout business altogether to avoid conflicts with clients like TPG and Kohlberg Kravis Roberts.

Not Goldman. It raised a \$20 billion fund, its sixth, at the height of the pre-crisis boom. Moreover, the firm and its partners accounted for around a third of the fund's money.

Part of the allure for state pension funds, sovereign wealth funds and others is investing alongside Goldman and its people.

That model is threatened by the Volcker Rule. But while the rule limits how much of their own money banks can sink into a fund, it doesn't on its face place the same restriction on investments made directly from their balance sheets.

In theory, that means Goldman or another bank could make a direct investment and bring other investors along for the ride through a single purpose mini-fund managed by the bank – a bit like the merchant banks of yore. In a traditional buyout fund, losing bets offset winning ones in calculating the manager's performance fees. Not so if the deals are done one by one: the manager would collect on the winners, but there would be no offset for the losers. That potentially works to the fund manager's advantage.

True, the rules potentially limit this kind of investment in other ways, such as through higher capital charges. And investors might push back, too – demanding, for example, lower fees, higher performance hurdles or some sort of clawbacks. But however it turns out it's something Tall Paul surely didn't intend.

Published on May 12, 2011



LONG-TERM LLOYD

BY ROB COX

As Goldman Sachs continues to be the subject of legal inquiry, guessing the longevity of Lloyd Blankfein's tenure as chief executive has become the summer's Wall Street parlor game. Even Warren Buffett opined on the subject earlier this month (naturally he wants him to stay).

Barring any new, unsavory disclosures, it's hard to see why Goldman's board shouldn't back Blankfein for his handling of pre-crisis business practices. The greater worry is Goldman's financial performance. Either way, Goldman should use this period of soul-searching to seize on a chance to improve its governance.

Talk of Blankfein's safety atop Goldman, which he has now led for five years, stems largely from questions of whether the firm acted improperly ahead of the 2008 financial crisis by, among other things, short-changing clients; and whether Blankfein misled Congress about the firm's bets against the housing market.

On balance, these offenses look like misdemeanors no worse than those committed by other banks. JPMorgan recently settled similar charges. As for Blankfein's Congressional testimony, his remarks on Goldman's bets against the housing market surely ring today as economical. But to make a case for perjury requires a far higher standard of proof – one that the facts at present don't seem to support.

Of course, the Justice Department and New York's Attorney General are continuing to scour legal documents, emails and trading records. They could still find something fresh that implicates the firm. For that reason alone, the board needs to keep Blankfein in place. As a former top partner of the firm says, Blankfein's resignation could be the "collateral for a trade" that authorities eventually seek as a settlement – or, in extremis, to head off an indictment. In light of this, the board should also have a succession plan in place. And there are some alternatives to Blankfein floating around, such as Asia-based vice chairman Michael Evans or investment banking head David Solomon.

But barring any further bad legal news, Blankfein looks safe, no? Only to a point. What matters most to Goldman's board and shareholders is financial

performance – a glimpse of which will come when the firm reports second-quarter earnings on Tuesday.

On this front, the news is mixed for Blankfein. The stock has shed nearly a quarter of its value so far this year, on a par with Morgan Stanley but worse than declines in Citigroup and JPMorgan. Indeed, the stock is now hovering at around book value – outside of the financial crisis that's a rarity for Goldman, though it's still a premium to most peers.

True, under Blankfein, the value of Goldman's assets minus liabilities per share has more than doubled. And the firm is still the leading adviser to global companies on mergers. This is viewed as a critical symbol of the bank's focus on clients.

Yet even if Blankfein can pull Goldman out of its market slump and avoid further legal issues, the board should strengthen the way the firm is run by separating the chairman and CEO positions, something many of its rivals have already done.

Moreover, there's a catalyst in the near future for doing so. By next year the firm needs to name a new presiding director to replace John Bryan, the former Sara Lee chief who turns 75 this year and chairs Goldman's corporate governance and nominating committees. Though Goldman's top brass may argue Bryan has played a role akin to an independent chairman, he's been invisible to most of the firm's rank and file, regulators and politicians.

The past two years of stinging public opprobrium, regulatory woes and congressional scrutiny should have highlighted a glaring weakness in the Goldman model to its board.

A seasoned chairman, distinct from the CEO, would provide cover in navigating the shifting regulatory and political tides. And the more independent the chairman is, the more likely he'd be to judge when Goldman's practices veered too closely away from assisting clients to serving its short-term interests. That would be a great help to Blankfein – or any of his possible successors.

Published on July 18, 2011

PIECE OF MIND

BY ROB COX

Goldman Sachs has often helped chief executives boost their companies' shares by breaking them into pieces. The U.S. bank run by Lloyd Blankfein is currently advising Kraft Foods on its split and counseling McGraw-Hill on whether it should do the same. So it's logical that some inside Goldman have run the numbers on their employer. The results are compelling. Should the firm's stock linger below its book value, or assets less liabilities, of about \$130 a share for much longer, a breakup could be hard for the firm's board to resist.

There's no suggestion for now that Goldman is considering such a radical maneuver. Most of its peers are also trading at a discount to book value, suggesting a sector-wide issue rather than something Goldman can easily tackle individually. And the company has a long-held view that the individual pieces – an industry-leading investment bank, a massive securities trading operation and an asset management arm – function best in combination.

Yet based on current market metrics, Goldman's parts are potentially worth a lot more than the whole. And many of the justifications that the firm has given in the past for maintaining its structure look out of step with the changing global regulatory framework.

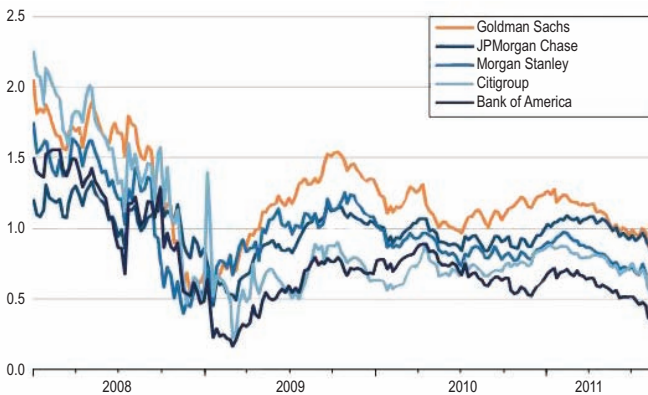
The starkest illustration of this mismatch comes in asset management. The Volcker Rule provision of the U.S. Dodd-Frank Act stipulates that a bank's own money cannot comprise more than 3 percent of a private equity fund it manages. At present Goldman's own capital accounts for a third of the \$20 billion fund overseen by GS Capital Partners. Once the Volcker Rule becomes effective, the benefit of investing Goldman's money alongside clients' cash will be much diminished.

It could, however, be the simple dollars and cents that eventually talk loudest. Valuing each of the firm's pieces is art as well as science, partly because the company's published financial statements do not show the profitability of each segment in detail. But the available information does support a rough sum-of-the parts analysis.

First take Goldman's investment banking unit, which includes advising companies on mergers and acquisitions and underwriting on behalf of clients. If the group extends its first-half performance for the rest of the year, it will make about \$5.4 billion in revenue. On a multiple of four times sales – a deserved premium to smaller rival Greenhill which trades at three times – the unit could be worth \$22 billion.

Then there's asset management, which oversaw \$844 billion of assets as of June 30. This includes Goldman's private equity funds, with all the Volcker Rule uncertainty over their future. It's hard to value this business because its profitability isn't clear. The firm is also restructuring the unit. But valued at 10 percent of assets under management – roughly in line with Blackstone Group – Goldman's alternative investment activities alone may be worth \$15 billion. At 2 percent of assets, the rest of the unit would fetch a price of around \$14 billion.

Goldman's book value vs rivals



Source: Thomson Reuters Datastream

Reuters graphic/Van Tsui

Add these pieces up and fold in a near \$7 billion stake in Industrial and Commercial Bank of China and some other investments held directly on the Goldman balance sheet, and their value already exceeds the company's \$53 billion market capitalization.

That means Goldman's Institutional Client Services arm, which generated 53 percent of revenue in the first half of 2011, comes for free. This business houses one of the industry's top prime brokerages servicing hedge funds, as well as desks dealing in equities, fixed income, currency and commodities around the globe.

This business has its problems. In the six months ended in June, revenue declined 25 percent from the same period in 2010 partly as a result of new rules that prohibit banks making market bets with their own money. And there may be more bad news to come as the business further adjusts to new regulations. And while Goldman is a bank holding company with access to Federal Reserve lending, investors might balk at funding a standalone trading business in a crisis.

Nonetheless, it's hard to see how Wall Street's most profitable trading business over the last decade can have no value at all to shareholders. Breaking up Goldman may not be the legacy Blankfein hoped to carve out of his tenure. But if clients regularly take the firm's advice to break up, it would be hypocritical of him not to consider the possibility himself.

Published on Sept. 7, 2011

ABOUT US

Reuters Breakingviews is the world's leading source of agenda-setting financial insight. Every day, Breakingviews comments on the big financial stories as they happen in the United States, Europe and Asia. Expert analysis is provided by a global team of 30 correspondents based in London, New York, Washington, Hong Kong, Madrid, Moscow, Dubai and Mumbai.

Our columns reach financial professionals, including asset managers, senior corporate executives, investment bankers, lawyers, traders and private equity partners, by way of 500,000 Thomson Reuters desktops and on Breakingviews.com, a subscription website. Selected content is also syndicated to Reuters.com and over a dozen influential publications including The New York Times, The International Herald Tribune, The Globe & Mail and Le Monde. Founded in 1999, Breakingviews.com was acquired by Thomson Reuters in 2009 and is now Reuters' brand for financial commentary.

CONTRIBUTORS

Breakingviews wishes to acknowledge the following individuals for their valuable contributions producing this book:

Clive George
Nicola O'Hara
Van Tsui
Nita Webb

And a special thanks to Alexandra Spychalsky for all her hard work

LOSING LUSTER

GOLDMAN SACHS UNDER LLOYD BLANKFEIN

In this collection of punchy and analytical columns, Breakingviews journalists chronicle the topsy-turvy ride of Goldman Sachs since Lloyd Blankfein took over as chairman and chief executive in 2006. In that time, Goldman has gone from virtually untouchable to basically unremarkable.

Time was, the investment bank was the envy of its industry. Rivals benchmarked their own performance against Goldman's. Its reputation seemed even more assured early in the U.S. housing slump as it sidestepped the embarrassing losses that plagued others. That changed as the crisis worsened.

Uncomfortable appearances before Congress, regulatory changes and a couple of trading slip-ups compounded Goldman's own responses to being branded "a great vampire squid," criticism of conflicts of interest and a whopping \$550 million fine imposed by the Securities and Exchange Commission.

This book, which covers more than five years of Goldman history and also looks to the future, should provoke thought and debate about whether the firm can rise again and whether it can do so without a change to its corporate structure – and maybe even its management.