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Some Backup for Goldman on A.I.G.

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For almost two years, Goldman Sachs has been spinning what many believed was a far-fetched tale.

Goldman has maintained that it had entirely hedged its exposure to the American International Group before A.I.G. collapsed in September 2008. Goldman's chief financial officer, David Viniar, has repeated over and over again: "We had no direct exposure."

Wall Street laughed. Congress laughed. The media laughed. Impossible!

Just last week, Elizabeth Warren, the chairwoman of the Congressional Oversight Panel, reiterated her skepticism during a Senate hearing. "We cannot evaluate the credibility of their claim that they had nothing at stake one way or the other in the A.I.G. bailout," she said.

A popular narrative has been constructed that government officials, led by Henry M. Paulson Jr., then Treasury secretary and the former chief executive of Goldman, and Timothy F. Geithner, then the president of the Federal Reserve Bank of New York, saved A.I.G. to save banks that were exposed to the insurance giant — and in particular Goldman.

So what was Goldman's exposure? According to some newly released documents, perhaps far less than its detractors maintain.

First, some numbers by way of background. Goldman Sachs originally had bought about $20 billion in protection against an underlying portfolio of collateralized debt obligations, or C.D.O.'s, with exposure to A.I.G. By that September, given the decline in the value of those instruments, Goldman's gross exposure was $10 billion. A.I.G. posted $7.5 billion in collateral, leaving Goldman exposed to a potential $2.5 billion loss.

But documents released by the Senate Finance Committee late Friday suggested Goldman was trying to brace for that potential loss. It now appears that Goldman had hedged itself against such a potential loss by buying $1.7 billion in insurance on A.I.G. from more than 30 different banks, and made other bets against A.I.G. worth more than $600 million. Whether it would have all paid off remains an unanswered question.

Another document — released by the House Committee on Oversight and Government Reform — has gone unnoticed and might be even more important. It contains an e-mail message to Mr. Geithner, sent on Sept. 16, 2008, at 12:02 p.m., just as he and the board of the Federal Reserve were deciding to inject $85 billion into A.I.G., which they did several hours later.

The e-mail message came from one of Mr. Geithner's lieutenants, Brian Peters. In the message, Mr. Peters said that he had just spoken to Goldman's chief risk officer, Craig Broderick.

Mr. Peters spelled out his understanding of Goldman's direct exposure to A.I.G. to Mr. Geithner. He said that Goldman's "net exposure is $2.3 billion," but immediately added, "They have credit hedges of $2.5 billion, $500 million of which is internal, so they are roughly flat."

Of course, Goldman Sachs would most likely have been susceptible to broader market problems had A.I.G. failed, a point that the firm has long acknowledged. And, had A.I.G. gone bankrupt, it is possible that a judge would have sought to claw back the $7.5 billion in collateral that A.I.G. had posted with Goldman, but that is an open question.

"I am not saying that we would have been unaffected; I don't think there is any company in the world that would have been unaffected by a failure of A.I.G. because all of the world's financial markets would have been affected," Mr. Viniar said in a conference call last year.

In that same e-mail message to Mr. Geithner on Sept. 16, 2008, Mr. Peters had put together a model of the worst case for Goldman in an industrywide Armageddon situation after an A.I.G. failure.

His estimate, which he admitted in the e-mail message "tries (crudely) to look at market effects and could be too dark," was a $6 billion loss for Goldman. Even Mr. Peters said at the time, "Bottom line: their number is essentially the current number."

In other words, the Fed believed Goldman was hedged the day it saved A.I.G.

But were its numbers right? By the calculations of the documents released Friday, Goldman had hedged its $2.5 billion exposure with somewhere from $2.375 billion to $2.5 billion on the other side, meaning it was pretty close to being fully hedged, with a little bit of wiggle room on either side of those numbers.

Of course, some of the insurance came from financial institutions that probably would have suffered to some degree and might have struggled to make the payments. Lehman Brothers (which was bankrupt) and Citigroup were among the firms that had provided the insurance.

On Friday, Senator Charles E. Grassley asked, in questions for Ms. Warren's panel: "Is it possible that financial health of the other institutions on the list may have prevented them from being able to pay Goldman in the event of an A.I.G. default?"

The answer is yes, but only a little bit. Goldman had been demanding cash collateral from all its counterparties up until A.I.G.'s near failure, so that even if one of its counterparties could not make the payment, it already had most of the cash. "We have said repeatedly that we had no direct material economic exposure to A.I.G.," Lucas van Praag, Goldman's spokesman, told me.

"Banks from whom we purchased credit protection, including Lehman Brothers, were required to post collateral to settle their net exposure to us on a daily basis. A default by any particular counterparty would not have created credit exposure for us if adequate collateral had been posted, which was the case. Put simply, our risk was limited by the fact that we already had the money." A.I.G.'s rescue has repeatedly been described as a "backdoor bailout" of Wall Street. In fact, it was a front door bailout aimed at stabilizing the entire financial system.

Whether any of the big banks, including Goldman, could have withstood the domino effects of an A.I.G. collapse is uncertain. But Goldman seems to have been better prepared for the worst than anyone would have believed.

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