

## Warren Buffett's Wall Street War

*TSF's (Dark Comedy) Commentary* – October 20, 2009

By Janet Tavakoli

In a [January 2009](#) interview with NBC's Tom Brokaw, Warren Buffett criticized leveraging "to the sky," and creating "[phony instruments](#) [RMBSs, CDOs, et al.] that fool other people so you stick money in your pocket." In 2002, he claimed over-the-counter derivatives are "financial weapons of mass destruction"<sup>1</sup> and participants who account for them have "[enormous incentives to cheat.](#)"<sup>2</sup>

Warren Buffett, the blogosphere's "[Oracle of Omaha](#)," often chastises the financial community. If you cost him money, he's liable to write an expose. He posts annual shareholder letters on a [low-tech website](#) and seems to labor under the assumption that rational people eagerly read his blog. Congress and regulators are dismissive of Buffett's hyperbolic rhetoric; it is fit only for a [banana republic](#).

In 2003, [Buffett wrote](#) of the manufactured housing industry's "business model centered on the ability...to unload terrible loans on naïve lenders...The consequence has been huge numbers of repossessions and pitifully low recoverie[s]." <sup>3</sup> Buffett alleged that the manufactured housing industry's consumer financing practices were "atrocious,"<sup>4</sup> and securitizations provided the money to fuel the financing.

Berkshire Hathaway's investment in the distressed junk debt of Oakwood Homes lost money after the designer and manufacturer of modular homes went bankrupt in 2002. Buffett claimed "Oakwood participated fully in the insanity."<sup>5</sup>

Warren Buffett's diatribe suggested that most of the manufactured housing industry was involved along with several Wall Street firms that underwrote the securitizations. Using money from new investors to pay returns to old investors in unsupportable investments is called a Ponzi scheme.

Oakwood's loans to purchasers of manufactured homes were made possible by a line of credit from Credit Suisse First Boston (Credit Suisse). The credit line was similar to a credit card except that Oakwood had to put up the home loans as collateral. Credit Suisse earned fees for the loans and further fees when it packaged (securitized) Oakwood's loans. Credit Suisse (the old investor) bought the securitized loans and then sold them to new so-called sophisticated investors.

Sales of manufactured homes declined. Loan delinquencies (late payments) and repossessions rose. Oakwood Homes had crushing debt and falling income for at least three years before it filed for bankruptcy in November 2002. But securitizations had

temporarily inflated the bubble for the collapsing enterprise. A June 2008 court opinion said Oakwood's aggressive lending practices led to the high number of repossessions and a debt load that Oakwood could not support. Oakwood's liquidator said the transactions it did with Credit Suisse were "value destroying."<sup>6</sup>

Someone should have muzzled Warren Buffett back in 2003. The Slumbering Esquires' Club might have believed Buffett's preposterous theory that after private securitizations became popular, the "industry's conduct went from bad to worse."<sup>7</sup> Buffett's wacky warnings could have jeopardized Wall Street's subsequent [mortgage lending securitization Ponzi scheme](#).

The SEC might have [investigated Lehman Brothers'](#) questionable shenanigans, especially after it was held liable in 2003 by a California jury for allegedly helping FAMCO cheat borrowers. The SEC might have looked into the unsavory practices at [Goldman Sachs Alternative Mortgage Products](#), [Bear Stearns](#), [Merrill Lynch](#) or [the entire private securitization industry](#), and [their mortgage lending subsidiaries](#).

While [the SEC slept](#) inside a collapsing debt bubble, the Omaha conspiracy theorist spooked Goldman Sachs into believing it needed his money. In the fall of 2008, Buffett closed [a deal](#) for \$5 billion in Goldman Sachs's preferred stock paying a 10% annual dividend. Goldman even gave Buffett warrants to buy \$5 billion in common stock at a price of \$115 anytime before October 1, 2013. [The Fed let Goldman buy back its warrants for [chump change](#).<sup>9</sup>] Buffett's warrants are now about \$3 billion in-the-money and worth much more—a sweetener for his [crispy calamari](#).

Hank Paulson, Ben Bernanke, and Tim Geithner<sup>10</sup> ignored the historic ravings of the [most successful living investor](#), and fueled some of the bombers piloted by Wall Street before finance's Pearl Harbor. After they used taxpayer money to save the system and [enriched the culpable](#) with no strings attached, Buffett said "[it could have turned out a lot differently](#)," and called each of them [a four-letter word](#). The label was undeserved.

Four-letter words aside, Warren Buffett raised a good point. It could have—and should have—turned out a lot differently. But it's not too late. Buffett called the crisis an [economic Pearl Harbor](#) and said that "[Wall Street owes the American people one at this point](#)."<sup>8</sup> During World War II, we imposed an excess profits tax. We should impose a 95% [excess profits tax](#)—or [windfall profits tax](#)—on certain financial institutions (including [Goldman Sachs](#)) enriching themselves with ongoing low-cost Fed funding and debt guarantees. [**JT Note:** Warren Buffett did not call for a windfall profits tax, but we should consider it with a host of other reforms.]

Adapted from [Dear Mr. Buffett, What an Investor Learns 1,269 Miles from Wall Street](#) (Wiley 2009) by Janet Tavakoli

Disclosure: Janet Tavakoli is an investor in Berkshire Hathaway Inc.

[Janet Tavakoli](#) is the president of Tavakoli Structured Finance, a Chicago-based consulting firm to financial institutions and institutional investors. She is the author of a book on the cause global financial meltdown: [Dear Mr. Buffett: What an Investor Learns 1,269 Miles from Wall Street](#) (Wiley, 2009).

She is also the author of [Credit Derivatives & Synthetic Structures](#) (Wiley, 1998, 2001), [Collateralized Debt Obligations & Structured Finance](#) (Wiley, 2003), [Structured Finance & Collateralized Debt Obligations](#) (Wiley, September 2008).

**Notes:**

1 [Berkshire Hathaway Inc. 2002 Annual Report](#), 15.

2 Ibid., 13.

3 [Berkshire Hathaway Inc. 2003 Annual Report](#), 5.

4 Ibid.

5 Ibid.

6 OHC Liquidation Trust, et.al v. Credit Suisse First Boston et al., U.S. Bankruptcy Court, Delaware. Civil Action No. 07-799 JJF (Chapter 11 Case No. 02-13396) Memorandum Opinion June 9, 2008. (Partial Summary Judgment)

7 Ibid. [1]

8 [Warren Buffett on ABC's Good Morning America, July 9, 2009.](#)

9 The Treasury got a paltry 23% return on its [\\$10 billion investment in preferred shares and warrants](#) in Goldman Sachs. The Fed accepted only \$1.1 billion for warrants that had more than nine years to run during a quarter when Goldman Sachs was awash in cash and profits and would report record earnings made possible only by taxpayer intervention. The Fed gave up the right to buy 12.2 million shares of Goldman for \$122.9 per share. [As of Oct 16, the warrants were in-the-money by around \$750 million and would have been worth much more with just over nine years to the original October 26, 2018 expiration date.] This does not include ongoing near zero-cost funding, relaxation of accounting terms, temporary protected status as a [bank holding company](#) (guarding against a run on Goldman) before [switching its status to a protected financial holding company](#) on August 14, 2009 [The Treasury may designate it a [Tier 1 Financial Holding Company](#)], and issuance of \$25.15 billion (as of [June 2009](#)) unsecured FDIC guaranteed debt [GS is allowed \$35 billion outstanding prior to Oct. 31, 2009. Goldman's first issuance was for \$5 billion of 3.35% maturing in 2012 on November 25, 2008; at the time its stand-alone debt traded at 8.25% for a comparable maturity].

10 In the fall of 2008, Henry ("Hank") Paulson was Treasury Secretary (Paulson was formerly CEO of Goldman Sachs), Ben Bernanke was (and currently is) the Chairman of the Federal Reserve, and current Treasury Secretary Timothy Geithner was the President [corrected 10/27/09. A previous version listed him as Chairman] of the New York Fed. Stephen Friedman, a former Goldman Sachs Chairman and CEO, was FRBNY Chairman [corrected 10/27/09. Previous version said he succeeded Geithner as Chairman] and owned shares of Goldman Sachs and was a member of Goldman's board while he held his influential Fed position, a conflict of interest

and a violation of Fed policy (for which he obtained a waiver – added for clarity on 10/27/09). Friedman resigned the Fed position in May 2009.]

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