Goldman Sachs made billions by pushing AIG to bankruptcy

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An investigative report published Sunday by the *New York Times* provides a glimpse of the predatory practices of major Wall Street banks that played a central role in the financial meltdown and global economic crisis.

The article, headlined "Testy Conflict With Goldman Helped Push AIG to Precipice," documents the role of Goldman Sachs, the biggest and most profitable US investment bank, in pushing the insurance giant American International Group (AIG) to the brink of bankruptcy.

At the height of the financial crisis, in mid-September 2008, the Bush administration stepped in to rescue AIG with $85 billion in taxpayer money. Since then, under Bush and then Obama, government aid to the company has grown to $182.3 billion. The firm is currently 80 percent owned by the US Treasury.

AIG has used its government bailout to award its top traders and executives hundreds of millions of dollars in bonuses. In the face of public outrage, the Obama administration has intervened to shield the company and block any moves to limit these pay awards.

The *Times* article, by Gretchen Morgenson and Louise Story, is based on a review of internal AIG documents and a recording of a January 28, 2008 conference call between Goldman Sachs executives and AIG. It describes how Goldman, in the two years preceding AIG's bailout, worked to undermine investor confidence in the insurer, then the biggest seller of credit default swap contracts, and drive down the market value of mortgage-backed securities.

During this period, Goldman was betting on a collapse of the housing bubble, which it had helped inflate by promoting sub-prime mortgages. Even as Goldman's top traders were structuring credit default contracts with AIG on mortgage-backed securities in a manner that enabled the bank to profit from a decline in the price of these securities, Goldman was making money by purchasing the same type of securities for clients and charging fees for bundling home loans into so-called "collateralized debt obligations" and selling the mortgage-backed CDOs into the market.

By means of the unregulated multi-trillion-dollar credit default swap market, banks and corporations purchase insurance against the default of bonds issued by other banks, companies and governments. If a seller of swaps—AIG was by far the biggest—goes bankrupt, its counterparties stand to lose billions.

By the fall of 2008, AIG was vastly over-leveraged and hemorrhaging cash due to demands from its counterparties, including major banks and financial firms in the US and internationally, that it fulfill its guarantee to make good on mortgage-backed CDO losses. Its failure threatened to tip some of the biggest banks, including Goldman and Morgan Stanley in the US, into bankruptcy.

The *Times* article suggests that Goldman was using its close relationship with AIG to manipulate the housing market and encourage a panic selloff of mortgage-backed assets, in part by pressing the insurer to make billions of dollars in collateral payments based on Goldman's "low-ball" estimates of the value of mortgage-backed CDOs it had insured with AIG.

The article notes that Elias Habayeb, an AIG accounting executive, testified before Congress in January that Goldman's payment demands were a major factor in AIG's downfall.

The implication is that the financial crash was not simply the result of disembodied "market forces." Highly conscious profit-driven calculations by financial giants such as Goldman played a critical role.

The *Times* reports: "The SEC [Securities and Exchange Commission] wants to know whether any of [Goldman's demands on AIG] improperly distressed the mortgage market, according to people briefed on the matter who requested anonymity because the inquiry was intended to be confidential."

The authors write, "Well before the federal government bailed out AIG, in September 2008, Goldman's demands for billions of dollars from the insurer helped put it in a precarious financial position by bleeding much needed cash."

They continue, "Goldman stood to gain from the housing market's implosion because in late 2006 the firm had begun to make huge trades that would pay off if the mortgage market soured. The further mortgage securities' prices fell, the greater were Goldman's profits."

The article indicates that Goldman made billions of dollars by extorting cash from AIG and then made billions more at taxpayer expense from the government bailout of the insurer. According to the *Times*, the bank collected over $7 billion from AIG in just one year before the government bailout of the insurer, and received another $12.9 billion when the government, as part of the federal rescue of AIG, covered in full the money AIG owed Goldman on insured housing securities.

At the time of the AIG bailout, then-Treasury Secretary Henry Paulson, Federal Reserve Chairman Ben Bernanke and then-President of the Federal Reserve Bank of New York Timothy

Geithner secretly funneled a total of $62 billion from the rescue of the insurer to AIG's major bank counterparties. Goldman was by far the biggest beneficiary of this back-door taxpayer bailout of the banks.

Other recipients included Morgan Stanley and JPMorgan Chase, each of which netted billions of dollars in the furtive transaction. The French bank Société Générale received $11 billion. According to the *Times* article, a portion of that money was subsequently transferred to Goldman Sachs under an agreement the two banks had made.

The *Times* reports that in December 2006 Goldman began to increase its negative bets on the mortgage market. Some months later it began to demand that AIG pay it billions of dollars on mortgage-backed securities the bank valued considerably lower than either AIG or third-party entities. AIG objected to Goldman's valuations and attempted for more than year to resolve the dispute, to no avail.

The article cites a January 28, 2008 conference call between 21 Goldman executives and AIG that lasted more than an hour and ended without any retreat by Goldman from its hard-line position. The *Times* reports AIG's suspicions that Goldman was encouraging other banks to take a similarly aggressive position.

Finally, on August 18, 2008, "Goldman's equity research department published an in-depth report on AIG. The analysts advised the firm's clients to avoid the stock because of a 'downward spiral which is likely to ensue as more actual cash losses emanate' from the insurer's financial products unit." This was tantamount to a death sentence for the insurance firm.

While the *Times* article paints a damning picture of the predatory role of Goldman Sachs, it omits any mention of the most crucial aspect of the story. What emboldened Goldman to pursue a course that could easily have backfired and driven it into bankruptcy along with AIG?

The answer is its certainty that the government would step in to cover its potential losses from an AIG collapse. At the heart of the Goldman saga is the incestuous and corrupt relationship between the most powerful Wall Street firms and the government.

For many years, the subordination of the US political system—including both parties and extending from the White House to Congress, to the courts and the media—to the financial elite has been exemplified by the role of Goldman in Washington. Known on Wall Street as "Government Sachs," the bank has funneled top executives into the highest government positions, in Democratic as well as Republican administrations.

The Obama administration is stacked with Wall Street insiders, including protégés of Robert Rubin, the former top Goldman executive who served as Bill Clinton's treasury secretary. These include Obama's chief economic adviser, Lawrence Summers, and his treasury secretary, Timothy Geithner.

Henry Paulson was chairman of the board and CEO of Goldman before he took the post of treasury secretary under George Bush in June of 2006. Paulson, working closely with then-New York Fed President Geithner, engineered the bank bailout in the fall of 2008, including the AIG rescue that was used to cover the potential losses of Goldman and AIG's other bank counterparties.

With Paulson at the head of the Treasury Department, Goldman launched its strategy of profiting from and encouraging the collapse of the housing market and AIG. Since the AIG bailout, it has been revealed that Paulson was in constant communication with his successor at the helm of Goldman, Lloyd Blankfein, during the height of the financial meltdown in the fall of 2008.

Paulson, working with Geithner and Bernanke, not only organized the backdoor bailout of the banks via the AIG rescue, he personally fired the then-CEO of AIG and replaced him with a Goldman board member, Edward M. Liddy, who at the time owned Goldman shares now valued at more than $4 million.

Geithner has been implicated in efforts, recently revealed in emails between the New York Fed and AIG, to conceal the use of taxpayer funds handed to AIG to pay off its bank counterparties at 100 cents on the dollar. Obama's elevation of this long-time Wall Street fixer to the post of treasury secretary unequivocally demonstrated the class character of his administration as an instrument of the American financial aristocracy.

The actions of Wall Street banks such as Goldman and their government accomplices are criminal in the full sense of the word. As the *World Socialist Web Site* wrote of Paulson last August (See: "Paulson and Goldman Sachs: A dirty secret of the Wall Street bailout"), "There is every basis for launching a criminal investigation, and aside from potential violations of law, the destructive social consequences for hundreds of millions of people in the US and around the world of his policies—which are being continued by Obama—are incalculable.

"Paulson, however, is not an aberration. The multi-millionaire banker turned cabinet official is rather an embodiment of the domination of social and political life by a financial oligarchy, whose leading representatives partake in the revolving door between the corporate suite and the highest levels of the state. This Augean stable of reaction and corruption can be cleaned out only through the independent mobilization of the working class on the basis of a revolutionary socialist program."