Fallout from Goldman Sachs indictment spreads

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Britain and Germany announced their own investigations into the role of investment bank Goldman Sachs in losses incurred by UK and German banks, following Friday's indictment of Goldman by the US Securities and Exchange Commission (SEC).

In calling for the British Financial Services Authority to begin an inquiry, Prime Minister Gordon Brown angrily accused Goldman of "moral bankruptcy."

According to the civil complaint filed by the SEC, among the clients defrauded by Goldman was ACA Management LLC, the biggest investor in a subprime mortgage-backed collateralized debt obligation (CDO) marketed by Goldman in April of 2007.

ACA Management was subsequently absorbed by the Royal Bank of Scotland, which in 2008 paid Goldman $841 million to unwind ACA's exposure to the Goldman CDO. The British government bailed out the Royal Bank of Scotland and currently holds an 82 percent stake in the firm.

The German government said its BaFin regulatory agency would look into the $150 million in losses suffered by IKB Deutsche Industriebank AG on its investment in the Goldman CDO, called Abacus 2007-AC1. IKB failed in late 2007 and was taken over by a state-owned bank.

The British and German announcements point to the financial havoc wreaked internationally as well as in the US by the machinations of Goldman, the most profitable company in Wall Street history. The complaint filed by the SEC describes a plot between Goldman and hedge fund manager John Paulson to sucker institutional investors into buying into the Abacus CDO so that Paulson could reap a huge profit by betting on the failure of the CDO's underlying mortgage-backed securities.

In return for Goldman's services in packaging the CDO and marketing it as a sound investment, Paulson paid the bank $15 million. Goldman made money as well from selling tranches of the CDO to unwitting investors.

Paulson, who is not charged in the SEC indictment, approached Goldman in early 2007 seeking its help in enabling him to place a large bet that the mortgage market bubble would soon burst. Paulson needed to lure investors into betting the opposite—that it would continue to grow.

The Abacus CDO, the SEC indictment indicates, was devised as the means of essentially swindling investors into betting on a rise in the value of risky subprime mortgage-linked securities, so that Paulson and Goldman could profit from the expected failure of these same securities. The CDO was a so-called "synthetic" instrument—meaning investors did not actually buy any securities. Rather, they gambled on the future price of a selection of securities, much as people gamble on a horse race.

The SEC charges Goldman with "making materially misleading statements and omissions" in marketing the $2 billion Abacus CDO. Specifically, Goldman did not inform investors that the securities underlying the CDO had been selected by Paulson, instead claiming they had been chosen by ACA Management. And the bank led ACA Management to believe that Paulson & Co. was taking a $200 million "long" position—i.e., that the hedge fund was betting the securities would rise in value.

Meanwhile, with Goldman's knowledge and approval, Paulson loaded the CDO with the worst subprime securities on the market, to ensure that it would collapse. By January of 2008, some 99 percent of the CDO's securities had been downgraded. Paulson pocketed $1 billion from the failure of the CDO, while investors, including ACA Management and IKB Deutsche Industriebank, lost a total of $1 billion.

The SEC indictment cites Goldman emails reflecting the sense of urgency behind the creation of the Abacus CDO. The bank and Paulson had to launch the investment vehicle before the housing market crashed, or they would be unable to profit from the disaster.

An email from the Goldman trader who directly organized the CDO—and who is the only Goldman official named in the SEC indictment—states, "The whole building is about to collapse anytime now…" Another email to the trader from a more senior Goldman employee declares that "the CDO biz is dead, we don't have a lot of time left."

The type of financial plundering exhibited by Goldman Sachs and Paulson in this particular venture was by no means an aberration. It was—and remains—business as usual on Wall Street.

The *New York Post* reported Monday that the SEC is investigating transactions by Deutsche Bank, the Swiss bank UBS and the former Merrill Lynch (now owned by Bank of America) in the mortgage securities market in the run-up to the collapse of the housing market in 2007 and 2008.

In a letter Friday to New York District Court, where the SEC indictment against Goldman was lodged, the Dutch bank Rabobank alleged that Merrill Lynch "engaged in precisely the same type of fraudulent conduct in the structuring and marketing" of one its CDOs as Goldman did with its Abacus CDO. The Dutch bank said Merrill permitted an investor, Magnetar Capital LLC, to select risky assets for inclusion in Merrill's "Norma" CDO, while telling Rabobank the assets had been chosen by a neutral third party.

In a reply to the SEC indictment, Goldman argues that there was nothing unusual about its actions in relation to the Abacus CDO and denies that it misled ACA Management or any other investor. It also claims that it lost money on the CDO deal.

In fact, such machinations precipitated a financial meltdown and slump that have cost tens of millions of jobs and inflicted incalculable social misery in the US and around the world. The resulting mass unemployment is being used to permanently drive down wages and slash workers' benefits, and the bankrupting of national treasuries as a result of government bank bailouts is serving as the pretext for slashing basic social programs.

Those at Goldman Sachs and the rest of the Wall Street firms who are responsible for such policies are criminals and should be prosecuted as such.

These same individuals, due to the largess of the Bush and Obama administrations, have profited handsomely from the catastrophe of their own creation. They are making more money than ever.

Goldman made a record $13.4 billion profit in 2009. JPMorgan Chase, Bank of America and Citigroup have all reported bumper profits for the first quarter of 2010, and Goldman is expected to do the same when it issues its first quarter report today.

There are already signs that Wall Street feels confident it has nothing to fear from the SEC or the Obama administration. While the Dow dropped 125 points on Friday, led by a sharp decline in the share price of Goldman and other banks, and Asian and European markets closed down on Monday, the Dow rose 73 points, spearheaded by a rebound in Goldman stock and bank stocks in general.

When press reports emerged Monday that the SEC split 3-to-2 on the decision to indict Goldman, with the two Republicans on the commission voting against the move, Goldman shares, which had been down, rallied and ended the trading day up 1.6 percent at $162.32.