In Senate testimony

Goldman Sachs executives defend deceptive marketing of securities

Kate Randall
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Testifying Tuesday before a Senate investigative panel, Goldman Sachs executives defended their deceptive marketing of mortgage-backed securities and denied any responsibility for the global economic crisis.

Appearing before the Permanent Subcommittee on Investigations of the Senate Homeland Security Committee, CEO Lloyd Blankfein and other Goldman officials denied that they had bet against their clients in connection with the bank's packaging and marketing of subprime mortgage-backed collateralized debt obligations (CDOs).

Investment banking giant Goldman Sachs was indicted by the US Securities and Exchange Commission (SEC) earlier this month. The civil complaint charged Goldman with "fraudulent misconduct" in relation to a $2 billion CDO Goldman sold to clients in 2007.

The SEC alleged that Goldman, for a $15 million fee, brokered the CDO at the behest of hedge fund manager John Paulson, who placed bets against the very mortgage securities that were included in the CDO. Goldman, according to the SEC, did not inform its clients that Paulson played a role in selecting the mortgage securities and that he was betting that they would lose value.

Goldman was, according to the indictment, defrauding its clients by itself betting against the very securities it was selling, without informing its clients that it was doing so. Goldman clients lost $1 billion in the deal as the subprime mortgage market crashed, while Paulson made a profit of about $1 billion.

Opening the hearing, the chairman of the subcommittee, Senator Carl Levin (Democrat of Michigan), said that Goldman "helped spread toxic mortgages throughout the financial system… and when the system finally collapsed, Goldman profited from the collapse."

CEO Blankfein rejected this characterization, stating, "We didn't have a massive short against the housing market and we certainly did not bet against our clients. Rather, we believe that we managed our risk as our shareholders and our regulators would expect."

Despite the efforts of the Goldman executives to sidestep the Senate panel's specific questions about their operations, a clear picture emerged at the hearing of Goldman's deliberate policy of palming off as sound investments securities comprised of junk assets.

Internal emails and other Goldman documents produced by the Senate panel and referred to in the course of the hearing indicate that the company's actions in betting against the housing market yielded significant profits. Goldman generated $4 billion in trading profits in 2007, betting heavily on a sub-prime mortgage collapse.

A summary following a board of directors meeting at the firm stated, "[A]lthough broader weaknesses in the mortgage market resulted in significant losses in cash positions, we were overall net short on the mortgage market and thus had very strong results."

The fleecing operations of Goldman were not limited to the so-called Abacus CDO cited in the SEC indictment. The Senate subcommittee provided evidence of other complex securities during the same period as the Abacus CDO in which Goldman bet on a decline in the value of subprime mortgage-backed securities while selling the securities to its clients and customers.

Senator Levin referred to a June 22, 2007 email from Goldman senior executive Tom Montag to Daniel Sparks, then-head of the bank's mortgages department. Sparks appeared at Tuesday's hearing.

The email referred to a security called Timberwolf, a CDO being marketed by Goldman at the time. Montag wrote of the Timberwolf deal, "[B]oy, that timeberwof

[sic] was one shitty deal.” The CDO lost 80 percent of its value within five months of issuance.

Leading up to 2008, Goldman profited by packaging mortgages and selling securities backed by poor-quality lenders such as Washington Mutual, Fremont, and New Century, key players in the sub-prime market. Levin asked Sparks, “How do you get comfortable with all the New Century collateral?”

Another internal email cited by Levin referred to “crap pools” of securities that Goldman continued to sell to clients, even as it was betting against them. “Do you think they [your clients] know you think something is a piece of crap when you sell it to them, and then bet against it?” he asked.

Fabrice Tourre, the only Goldman employee charged with fraud by the SEC, also appeared at the hearing. He joined the firm in 2001 and later became a vice president on the structured product trading desk, where he helped create Abacus.

Tourre categorically denied the allegations against him. He claimed that Abacus was “not designed to fail” and that Goldman did not mislead its customers about the nature of the CDO at the center of the SEC indictment.

Senator Susan Collins, Republican of Maine, asked Tourre if he felt he had “a duty to act in the best interests of Goldman’s clients,” to which he responded, “I believe we have a duty to serve our clients, with respect to our role as a market-maker, by showing prices to clients and offering liquidity.”

In the wake of the SEC indictment, however, emails sent by Tourre to his girlfriend paint a picture of an environment at Goldman in which the firm knowingly marketed the toxic securities. In the emails he refers to himself as the “fabulous Fab” creating “Frankenstein” products concocted out of “pure intellectual masturbation” for sale to unsuspecting widows and orphans.

David Viniar, chief financial officer and executive vice president at Goldman since 1999, denied that the firm had deliberately bet against its clients, stating in his prepared remarks that the investment bank’s practices “had everything to do with systematically marking our positions to market, paying attention to what those marks were telling us, and maintaining a disciplined approach to risk management, which we believe served the firm, our clients, and our shareholders well during this extraordinarily challenging period.”

Other Goldman employees appearing at the hearing included Craig Broderick, chief risk officer since 2005, and Michael Swenson, managing director in fixed income currency and commodities at the firm since 2005.

While the Senate committee members—in particular, Democrats Carl Levin, Claire McCaskill (Missouri) and Edward Kaufman (Delaware)—struck a fiery pose in their questioning of the Goldman executives, their comments were confined to probing the “moral” and “ethical” failings of the investment bankers.

There were no calls for an expansion of the SEC indictment or for criminal charges to be brought against Goldman CEO Blankfein or other key players in a speculative operation that has had devastating social consequences for tens of millions of ordinary people in the US and around the world.

These actions, which helped precipitate the global financial collapse, have led to the loss of jobs, homes, and life savings, and resulted in untold misery for masses of people. The criminal practices that transpired at Goldman Sachs were not an aberration, but were repeated in banks and financial firms across the country.

The bank regulatory “reform” being promoted by the Obama administration and congressional Democrats will do nothing to rein in the power of the banks or curb their socially destructive behavior. The Senate investigation and SEC indictment of Goldman will at most result in a financial slap on the wrist for those involved, with perhaps one or two employees taking the fall.

The members of the Permanent Subcommittee of Investigations, moreover, have a personal stake in the continued profitability of Goldman Sachs. Four of the ten committee members—Republicans John McCain (Arizona) and Susan Collins (Maine) and Democrats Mark Pryor (Arkansas) and Jon Tester (Montana)—have accepted substantial contributions from the firm.

Since 1989, Goldman Sachs employees and the bank’s political action committee have given a combined $31.6 million in campaign contributions to the two big-business parties, two-thirds of this total to Democratic candidates.

The financial industry as a whole funded Barack Obama’s presidential campaign to the tune of $15 million. Goldman was Obama’s single biggest donor, giving nearly $1 million. The bank is the biggest corporate campaign donor to the Democratic Party.