Settlement in fraud case against Goldman Sachs: A cover-up of Wall Street crimes

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Goldman Sachs agreed Friday to pay $550 million to settle a civil indictment by the Securities and Exchange Commission (SEC) charging that the investment bank misled investors about $2 billion of junk securities it sold in 2007.

The settlement is a cover-up, engineered by the Obama administration to avoid a public trial that might expose not only criminal activities by Goldman Sachs and the hedge fund headed by John Paulson, but diverse forms of fraud and swindling commonly carried out by major Wall Street firms.

The Goldman case is particularly sensitive because the bank and its hedge fund partner engaged, in the SEC's words, in "fraudulent misconduct" in the run-up to the 2007 collapse of the subprime mortgage market. They did so in order to profit from the financial wreckage.

The SEC announced its case against Goldman last April. The settlement continues the government's policy of refusing to hold Wall Street executives accountable for the financial and social disaster caused by their actions. The SEC's indictment—which was civil and not criminal—did not name a single top executive of Goldman. Nor did it charge Paulson.

The $550 million fine imposed on Goldman amounts to about two weeks of the bank's annual earnings, a bargain in return for which the firm can anticipate a healthy rise in its stock value. Goldman's share price rose sharply Thursday after the agreement with the SEC was made public.

According to the *Wall Street Journal*, "Goldman brass told managers to make sure the reaction inside the firm was subdued," hoping that a solemn demeanor would make it less obvious that the bank was getting away with a wrist-slap. The company expressed satisfaction with the deal in its official announcement, which said the settlement was "the right outcome for our firm, our shareholders and our clients."

Goldman did not admit guilt in return for the shutdown of the case, stating only that it had made "a mistake" in its marketing materials for the investment at the center of the indictment.

The complaint filed by the SEC described a plot between Goldman and Paulson to sucker institutional investors into buying into Abacus 2007-Ac1, a subprime mortgage-backed collateralized debt obligation (CDO) marketed by Goldman in April of 2007. Paulson sought Goldman's help in packaging and marketing the subprime instrument so that he could make a huge profit by betting on the failure of the CDO's underlying mortgages.

Goldman agreed to take the job, in return for $15 million in fees. Paulson ended up pocketing $1 billion from the collapse of the mortgages and the losses of those who bought into the CDO.

Goldman made money as well from selling tranches of the CDO to unwitting investors.

Paulson approached Goldman in early 2007 seeking its help in enabling him to place a large bet that the mortgage market bubble would soon burst. The hedge fund manager needed to lure investors into betting the opposite: that it would continue to grow.

The Abacus CDO, the SEC indictment indicated, was devised for precisely that purpose. 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 charged 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 that they had been chosen by ACA Management. 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.

Goldman's public announcement of Thursday’s settlement noted that "the SEC staff also has completed a review of a number of other Goldman Sachs mortgage-related CDO transactions and does not anticipate recommending any claims against Goldman Sachs or any of its employees..."

According to Reuters, in 2007, the year the fraudulent security was issued, Lloyd Blankfein, Goldman's CEO, took home $100 million in pay and stock. Paulson pocketed $3.7 billion in 2007 and another $2 billion in 2008.