



FOR IMMEDIATE RELEASE  
Monday, April 26, 2010

Contact: Tara Andringa, 202-228-3685  
tara\_andringa@levin.senate.gov

## **Senate Subcommittee Holds Fourth Hearing on Wall Street and the Financial Crisis: The Role of Investment Banks**

WASHINGTON – The Senate Permanent Subcommittee on Investigations, whose chairman is Sen. Carl Levin, D-Mich., and whose Ranking Republican is Sen. Tom Coburn, R-Okla., will hold the fourth in its series of hearings on the causes and consequences of the financial crisis at 10 a.m. Tuesday, April 27, in room 106 of the Dirksen Senate Office Building.

Tuesday’s hearing will focus on the role of investment banks in the crisis, using Goldman Sachs as a case study. Previous hearings have examined how reckless mortgage lending, weak-kneed regulatory agencies and misleading credit ratings and the agencies that produced them contributed to the crisis.

The Subcommittee’s nearly 18-month investigation found evidence that Goldman Sachs, contrary to the repeated public statements of the firm’s executives, made and held significant bets against the mortgage market – “short positions” in Wall Street terms – and that at times those bets were not just against the mortgage market in general, but against securities that Goldman Sachs had assembled and marketed to its customers.

“Goldman Sachs, like all the major Wall Street firms, got a multibillion-dollar lifeline from the taxpayers in 2008,” said Levin. “Goldman Sachs was slicing, dicing, and selling toxic mortgage-related securities on Wall Street like many other investment banks, but its executives continue to downplay the firm’s role in the financial engineering that blew up the financial markets and cost millions of Americans their jobs, homes, and livelihoods. Goldman Sachs made billions of dollars from betting against the housing market, and it placed those bets in some cases at the same time it was selling mortgage related securities to its clients. They have a lot to answer for.”

Goldman and other investment banks played a crucial role in building and running the conveyor belt that fed toxic mortgages and mortgage-backed securities into the financial system. In Goldman’s case, this activity included underwriting securities backed by or related to mortgages from some of the most notorious subprime mortgage lenders, including Washington Mutual’s Long Beach subprime subsidiary, Fremont Investment & Loan, and New Century Mortgage. Goldman Sachs also designed and sold billions of dollars of collateralized debt obligations (CDOs) that further spread the risks associated with toxic mortgages.

Documents the Subcommittee will examine on Tuesday include internal reports and emails that make clear that, as high risk mortgages began to incur record delinquency rates, Goldman Sachs took on a significant “net short” position in the mortgage market throughout 2007, and cashed in shorts that generated substantial income. Those documents contradict repeated company statements to shareholders and the media denying that Goldman Sachs bet against the mortgage market or made substantial profit from doing so.

In late 2006, company officials sought to reduce Goldman’s exposure to the risk of holding a large inventory of mortgage-related securities on its books. It began to both reduce that inventory and to bet against such securities. It was hedging its risk and moving toward a balanced position. But within months, that neutral position shifted into a large bet against the mortgage market. Company documents show the firm taking every opportunity during early 2007 to take short positions against mortgages. And in reducing its risk, the firm aggressively sold its mortgage holdings to clients. Documents show the firm’s sales force raising questions about the quality of securities Goldman was trying to unload, and complaints from clients who posted big losses on products Goldman had sold them.

The bipartisan Subcommittee investigation has resulted in the following findings of fact regarding the role of investment banks in the financial crisis:

- (1) **Securitizing High Risk Mortgages.** From 2004 to 2007, in exchange for lucrative fees, Goldman Sachs helped lenders like Long Beach, Fremont, and New Century, securitize high risk, poor quality loans, obtain favorable credit ratings for the resulting residential mortgage backed securities (RMBS), and sell the RMBS securities to investors, pushing billions of dollars of risky mortgages into the financial system.
- (2) **Magnifying Risk.** Goldman Sachs magnified the impact of toxic mortgages on financial markets by re-securitizing RMBS securities in collateralized debt obligations (CDOs), referencing them in synthetic CDOs, selling the CDO securities to investors, and using credit default swaps and index trading to profit from the failure of the same RMBS and CDO securities it sold.
- (3) **Shorting the Mortgage Market.** As high risk mortgage delinquencies increased, and RMBS and CDO securities began to lose value, Goldman Sachs took a net short position on the mortgage market, remaining net short throughout 2007, and cashed in very large short positions, generating billions of dollars in gain.
- (4) **Conflict Between Client and Proprietary Trading.** In 2007, Goldman Sachs went beyond its role as market maker for clients seeking to buy or sell mortgage related securities, traded billions of dollars in mortgage related assets for the benefit of the firm without disclosing its proprietary positions to clients, and instructed its sales force to sell mortgage related assets, including high risk RMBS and CDO securities that Goldman Sachs wanted to get off its books, creating a conflict between the firm’s proprietary interests and the interests of its clients.
- (5) **Abacus Transaction.** Goldman Sachs structured, underwrote, and sold a synthetic CDO called Abacus 2007-AC1, did not disclose to the Moody’s analyst overseeing the rating of the

CDO that a hedge fund client taking a short position in the CDO had helped to select the referenced assets, and also did not disclose that fact to other investors.

(6) **Using Naked Credit Default Swaps.** Goldman Sachs used credit default swaps (CDS) on assets it did not own to bet against the mortgage market through single name and index CDS transactions, generating substantial revenues in the process.

Witnesses at Tuesday's hearing will include Goldman Sachs Chief Executive Officer Lloyd Blankfein, Chief Financial Officer David Vinier and executives who were involved in the assembly, marketing, sale, and trading of mortgage-related securities.

###