



## Goldman's magic in Abacus 2007-AC 1: Fraud?

*... can a Wall street firm be all at the same time: deal designer, position taker, counsel to position takers and market-maker without breaking the law?*

7<sup>th</sup> May 2010, by Médéric L. Pascal <sup>0</sup>



Goldman Sachs' headquarters in New York

THE FAMOUS WALL STREET FIRM: GOLDMAN SACHS (G.S.) HAS BEEN FILED FOR FRAUD BEFORE THE SOUTHERN DISTRICT COURT IN NEW YORK, NY BY THE SECURITIES AND EXCHANGE COMMISSION (S.E.C.)

The complaint filed by the S.E.C before New York's civil jurisdiction is the first result of an investigation initiated as soon as August 2008 upon the firm's precise role in emissions and transactions of residential mortgage backed securities (RMBS).

Fabrice Tourre (product designer at G.S.) and Goldman Sachs & Co. are named<sup>1</sup> for : “for making materially misleading statements and omissions in connection with a synthetic collateralized debt obligation (“CDO”) GS&Co structured and marketed to investors.”

The CDO under scrutiny is by nature a complex derivative and structured product launched April 2007 by Goldman Sachs and the asset management firm ACA Capital. The Abacus notes perform similarly to a collection of mortgage loans pooled in what the contract called the *Reference Portfolio* but open no rights for the investors onto the underlying assets, instead the proceeds are invested in other collaterals and in OTC default risk protection contracts – the now famous Credit Default Swaps or CDS – which replicates the performance and risks of the Reference portfolio.

Those investors were, in the case of Abacus 2007-AC1, the German investment bank IKB, the American asset management firm ACA Capital (co-designer of the contract) and the Dutch investment bank ABN Amro through a side protection contract sold to Goldman and covering ACA's risks.

Has the CDO been conceived in order to collapse? This is fundamentally the object of the disputed fraud case filed by the S.E.C. So far the Commission has limited its claims to the role of one of Goldman's privileged client (John Paulson) in the selection process of the reference portfolio and the non-disclosure to potential investors of this active role when the latter client had directly adverse interests to those of the investors. It is a fact the J. Paulson is not subject to the S.E.C. filing.

The underlying thesis is yet well that Fabrice Tourre has for the account of Goldman Sachs & Co. deliberately and knowingly composed the reference portfolio of RMBS-s that were largely overrated by rating agencies and that the CDO deal was intently structured for no other purpose than to allow Goldman Sachs and/or one of its privileged clients to enter a protection buyer position that should quickly turn out to be very juicy for them and very detrimental to the unlucky investors, as sophisticated and institutional as they might have been.

Now of course the burden of proof to such a far reaching thesis cannot be assigned to a federal agency that has neither the authority in law nor the means in practice to run a *criminal* investigation. According to a news report made public by the online edition of the Wall Street Journal, relayed by both online and print editions of the New York Times and the AP agency, the relevant US Attorney bureau in Manhattan is said to have initiated a preliminary criminal investigation upon Goldman Sachs' course of action in the Abacus deals following suit to a criminal referral in the S.E.C. civil case. Both authorities declined to comment about this information.



Why, lucky I was not born an Abacus!

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#### Notes

0. The original release of the present article was mistakenly dated 7<sup>th</sup> May 2007.

1. Source: S.E.C. Complaint filed April, 16<sup>th</sup> 2010