Financial Fraud and The Goldman Sachs E-Mails: How the Crash was Turned Into Cash

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NEW YORK – As the U.S. housing turned downward in January 2007, a Goldman Sachs trader wrote in e-mails to a woman he apparently was courting that investments he had sold were "like Frankenstein turning against his own inventor."

"I'm trading a product which a month ago was worth $100 and today is only worth $93," wrote Fabrice Tourre, who was charged along with the bank in a civil complaint filed this month by the Securities and Exchange Commission. "That doesn't seem like a lot but when you take into account … (the investments) are worth billions, well it adds up to a lot of money."

Tourre was talking about investment products like the one at the heart of a federal complaint against his firm. For Tourre, the investments were like an invention gone awry: He had started arranging them when the market was on the upswing. But he continued selling them after the market turned — now with Goldman betting against them, in one case allegedly misleading investors about a deal's origin.

Goldman Sachs Group Inc. released that e-mail and 25 other internal documents Saturday in response to a Senate panel's release of messages in which Goldman executives boast about money they were making as the market imploded later in 2007.

When credit rating agencies downgraded many billions of dollars of mortgage-backed investments in October 2007, Goldman executive Donald Mullen was unabashedly pleased.

"Sounds like we will make serious money," Mullen wrote to Michael Swenson, another executive, in one of the e-mails released by the Senate Permanent Subcommittee on Investigations.

Goldman has argued vehemently that it did not profit from the mortgage meltdown.

Swenson and Tourre, along with Goldman CEO Lloyd Blankfein, will face a public grilling on Capitol Hill Tuesday from the subcommittee.

Also this week, the full Senate will take up a proposed overhaul of financial regulation intended to toughen oversight of Wall Street and make the financial system more transparent. Republican leaders oppose the measures.

And Goldman has been in the glare of a particularly unforgiving spotlight since the SEC filed civil fraud charges this month over the investments Tourre was selling and discussing in his e-mail.

The SEC alleges Goldman misled two investors — IKB Deutsche Industriebank AG, a German bank, and ACA Management LLC, a U.S. bond insurance company — who bought complex mortgage-related products crafted in part by Paulson & Co., a New York hedge fund led by billionaire John Paulson. Paulson was betting the market would collapse. The SEC says Goldman didn't tell the investors that Paulson was involved in choosing the investments or that he was betting they would fail.

Goldman has denied wrongdoing and says it will fight the charges. It has said it lost money on the particular deal of Tourre's that the SEC charges address.

The SEC complaint contains excerpts from the same Tourre e-mail chains that Goldman released in full Saturday. The firm's move puts on full display the personal life of the trader, who had boasted that the market would implode, leaving only him standing. And it does so days before he makes his public debut.

"Obviously, the content of the e-mails is highly embarrassing, but we've found no evidence of wrongdoing," Goldman spokesman Samuel Robinson said.

Goldman's relative strength during the financial crisis and the prominence of many former Goldman executives have made the firm a lightning-rod for public anger over Wall Street's greed and recklessness. Even before the SEC charges were filed, the long-secretive bank was fighting accusations that its bets helped trigger and fuel the financial crisis.

Goldman also has become a useful symbol for Democrats in the escalating debate over the financial overhaul. In fact, Republicans charge that Democrats in the Senate and on the SEC are using the public's anger toward Goldman to build support for their plan.

The subcommittee will brief reporters about the Goldman hearing on Monday, the same day the Senate will have its first test vote on the Obama administration's financial package. The panel is expected to release documents that will be covered Monday evening online and in Tuesday's papers next to reports on the overhaul vote.

The SEC's inspector general confirmed Friday that he will look into the timing of the charges and possible leaks by the commission.

The internal e-mails among Goldman executives were released by subcommittee chair Sen. Carl Levin, D-Mich. In a statement, Levin called banks like Goldman "self-interested promoters of risky and complicated financial schemes that helped trigger the crisis."

In a statement Saturday, Goldman spokesman Lucas Van Praag said the bank lost $1.2 billion in the residential mortgage market during 2007 and 2008.

"As a firm, we obviously could not have been significantly net short since we lost money in a declining housing market," Van Praag said in a statement.

Van Praag is among the executives who wrote the e-mails the Senate committee released. He said the panel "cherry-picked" four threads out of 20 million pages Goldman provided.

"Of course we didn't dodge the mortgage mess," CEO Lloyd Blankfein wrote in a message dated Nov. 18, 2007. "We lost money, then made more than we lost because of shorts."

Short positions are bets that the market will go down. When the market went bust, people with short positions cleaned up.

Earlier in 2007, Goldman Chief Financial Officer David Viniar showed in one of the e-mail threads that the firm made more than $50 million in one day on bets the housing market would founder.

Viniar, also scheduled to testify Tuesday, summed up the contrast between Goldman's gains and the situation of investors who had not bet against the market:

> "Tells you what might be happening to people who don't have the big short."

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