



## REUTERS

April 28, 2010

# Goldman's More than a Wall Street Toll Collector

By Matthew Goldstein

Time and time again, that is how top officials with Goldman Sachs Group on Tuesday described their primary role in arranging and selling subprime mortgage-linked securities to institutional investors.

In nearly 11 hours of testimony before the Senate Permanent Subcommittee on Investigations, the phrase "market maker" was uttered nearly twice as often as an expletive used by a former Goldman executive to describe one of the busted subprime-backed securities it sold to investors in early 2007.

Goldman Chief Executive Lloyd Blankfein told the Senate panel that on any given day the investment company stands as a market maker on "hundreds of thousands, if not millions of transactions."

He said the firm's only real obligation is to make sure that a transaction is "suitable" for clients based on their level of sophistication and financial means.

There is truth to Goldman's defense that much of what it does in markets for

bonds, stocks, commodities, currencies and other asset classes is to act as a middleman in transactions between sophisticated buyers and sellers.

But fees associated with making a market tell only a part of the story when it comes to how big investment companies like Goldman make money -- especially on esoteric products like collateralized debt obligations.

### Missed Opportunity?

After all, Goldman is not paying its 31,000 employees \$500,000 a year, on average, simply to serve as Wall Street's version of a glorified toll collector.

Far more of Goldman's annual income comes from the trades or hedges it does every day to offset the risk it takes on as a market maker. And those hedges aren't simply designed to take a neutral position on a stock or bond. Sometimes they are intended to place a directional bet as well.

During Tuesday's hearing, Senator Carl Levin, the subcommittee chairman, tried to get Blankfein and other Goldman officials to admit that in shorting subprime mortgage debt in 2007, the investment company had taken unfair advantage of customers who were buying the subprime debt the bank was peddling.

Wall Street historian Charles Geisst said senators on the panel should have pointed out that if all Goldman was doing was hedging itself, it wouldn't have profited so handsomely from its short bets on subprime debt.

"If you have a perfectly balanced hedge then you shouldn't be making all that money," said Geisst, a professor of finance at Manhattan College.

Indeed, the distinction between trades that are done to hedge an exposure and trades that end-up generating a profit can and do get blurry. It's one reason investment firms do not break out specific revenue figures for proprietary trading -- trades done with a firm's own capital.

"There are two roles that Goldman plays," said Frank Partnoy, a former Morgan Stanley derivatives trader and law professor. "One is to make riskless fee income. And the other is to do proprietary bets, and the proprietary bets have become much more important than the fee piece."

#### 'Cover Story'

During the hearing, Senator Levin also strongly suggested there was something morally wrong with Goldman creating so-called synthetic collateralized debt obligations, which were used as vehicles for the investment firm and others to effectively lay wagers on the fate of the U.S. housing market.

But Blankfein & Co didn't cede any ground on that point either. In producing synthetic CDOs, the company's executives

said they were merely responding to a demand from customers for more ways to bet on the housing market.

And in providing that customer service, the Goldman was forced to balance out its potential exposure with short bets.

However, a former top derivatives trader for a European bank, who now works for a hedge fund, said Goldman's market maker defense is nothing more than a "cover story." The trader, who declined to be identified because he still works in the financial industry, said he sent a letter last night to Levin in which he took issue with Goldman's defense.

In the letter, the trader said: "If the market-making desk is allowed to run huge net exposures for more than minutes or hours, that is proprietary trading." He added, "A client expects the market-maker to act in good faith and not be warehousing the exposure."

A person familiar with Goldman's thinking but who didn't want to be identified said that from time to time an investment bank may need to be net long or net short a particular asset in order to manage for unexpected trades or client requests.

#### Anything But Plain Vanilla

Another issue with Goldman's market-maker defense is that complex structured products like CDOs are not natural byproducts of a vibrant capital market such as is the case with stocks or bonds.

Structured products are investment vehicles that Wall Street financial engineers create to sell as high-yield alternatives to stocks and plain vanilla corporate bonds.

One such product was auction rate securities, which attracted wealthy investors after Wall Street banks began peddling them as an alternative to traditional money market funds.

Early in the financial crisis, investors who put money into ARS deals lost billions when banks stopped making a market in them and investors found the securities were largely illiquid.

**Attorney Jacob Zamansky -- who generally represents plaintiffs suing companies on behalf of investors -- said Wall Street banks like Goldman owe a**

**higher duty of fair dealing with their customers when they create structured products.**

**"They have a greater responsibility," said Zamansky.**

**"Certainly more than when they stand in the middle of a stock trade," said Zamansky.**



## NATIONAL MORTGAGE NEWS

April 2, 2007

### Lawsuit Filed by Alleged Victims Of New York Mortgage Fraud

By Jennifer Harmon

MINEOLA, NY -- A \$100 million lawsuit has been filed in New York State Supreme Court in Nassau County here against some of the top mortgage lenders on behalf of a few dozen Long Island homeowners who say they are victims of a mortgage scam.

Jacob Zamansky, the principal of Zamansky & Associates LLC, is asking for a preliminary injunction to prevent the homeowners from losing their homes and being "forced out on the street." He says the plaintiffs are burdened with loans, which they are struggling to pay, which they procured as the result of a Ponzi scheme.

According to the lawsuit, Mr. Zamansky is asking for nature of relief filed against PHH Mortgage Corp., First National Bank of Long Island, Countrywide Home Loans Inc., Homecomings Financial LLC, Washington Mutual Inc. and IndyMac Bank, which hold the plaintiffs' home mortgage loans and mortgage-secured lines of credit from taking any steps such as collecting upon these debts, declaring the loans in default and foreclosing upon the mortgages of the homes.

It is the first court case to argue "suitability" standards, much in the same way brokers must put their client's assets in suitable investments, Mr. Zamansky told National Mortgage News. "This standard exists in New

York and there has been debate in the Senate and House during the last two weeks. If the court adopts our standard, other borrowers would benefit if they can demonstrate there were unsuitable loan recommendations and loans made to them by mortgage lending professionals."

Eighteen of the plaintiffs are over 60 years old, four are over 80, and all had their loan proceeds stolen from them, according to the lawsuit, which says defendant Peter Dawson, a former investment advisor, allegedly solicited the plaintiffs to take out mortgage loans on homes which were mostly paid off in full, misappropriated the loan proceeds by depositing them into his "disbursement account" and then paid their monthly loans for a period of time. Loans ranged from the amount of \$75,000 to \$330,000.

"The plaintiffs had monthly mortgage payments, which they can't pay, based on their incomes. These mortgages were unsuitable and there were warning signs of potential fraud at their closings," Mr. Zamansky wrote in the lawsuit.

"In short, he stole their money for himself and continued his Ponzi scheme until the funds ran out," the lawsuit said. "Mortgage lenders assisted in his fraud by extending the unsuitable loans to the plaintiffs who were

elderly or retired and lacked sufficient income and ability to repay the mortgages, without engaging in sufficient due diligence to qualify and approve them for the loans."

This case also involves blatant fraud in obtaining mortgages, Mr. Zamansky said. At the closings, the mortgage lenders, through their attorneys or mortgage broker agents, issued loan proceeds checks in many instances directly to Mr. Dawson or his company's disbursement account. They were often represented by an attorney who had been "indicted for mortgage fraud."

According to the lawsuit, the plaintiffs had no independent legal representation at the closings, nearly all of which were held at Mr. Dawson's office. By extending these loans, the lenders have earned and stand to earn over time enormous finance and interest charges on these loans.

In the lawsuit, Oasis is said to have breached its duties to Daniel and Harriet Agostinelli by qualifying them for a \$468,000 loan with no stated income. The couple earns approximately \$1,700 per month in income and must make \$3,700 in monthly mortgage payments. "Oasis acted as the agent for Homecomings, the lender, and received payment from Homecomings for qualifying them for the unsuitable loan," the lawsuit said.

The lawsuit is asking for declaratory judgment ordering all the defendant banks and mortgage companies to void and cancel the mortgage loans they made to Mr. Dawson's

clients and to immediately terminate and freeze all foreclosure proceedings against them. "The preliminary injunction also seeks to hold the lenders and brokers liable for the damages of the stolen loan proceeds based on their aiding and abetting Mr. Dawson's fraud."

Leonard Hecht, an attorney with 18 years experience in representing mortgage lenders, brokers and borrowers, says lenders do have a suitability obligation to know their borrower and believes that this was breached here. The standard requires mortgage lenders to "know their customer" and only qualify and approve borrowers where there is sufficient ability, means and willingness to pay the mortgage. Since the plaintiffs did not have their own legal representation and were directed to pay loan proceeds to a third party's disbursement account, and the borrowers did not have sufficient income, they would never have closed the loan.

"Most are living on fixed incomes such as Social Security and pensions. In taking out these loans, many plaintiffs were relying upon expected interest payments from Mr. Dawson who fraudulently solicited them to take the loan and invest with him," added Mr. Zamansky. The plaintiffs' attorney says his clients "should not fall into homelessness, have their credit ratings destroyed, or starve while struggling to pay burdensome debts which they cannot afford, while waiting for relief on their claims for redress." Mr. Dawson is now incarcerated in the Nassau County Jail.