ROUNDTABLE REPORT

Goldman Sachs

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BACKGROUND

- **ABACUS 2007-AC1** = synthetic CDO (side-bets on subprime mortgage bonds, no loans owned)
- **Core issue:** lack of clear disclosure about roles and incentives
- **Paulson & Co:** Hedge fund that invested on side of the deal to fail, without investors knowing
- **2010:** SEC charged Goldman with misleading disclosures; settled for **$550 million**
- **ABACUS became a symbol of how opacity leads to breaking trust and magnify losses**

TIMELINE

Jan-Apr 2007: ABACUS is made. Paulson proposes a short; Goldman structures a synthetic CDO; ACA named portfolio selector.

Apr 26, 2007: ABACUS closes; long investors take mortgage risk; short side profits if bonds weaken

Late 2007 - early 2008: housing market cools, more borrowers missed payments; results in big losses for long side, and around $1 billion in profits for short side

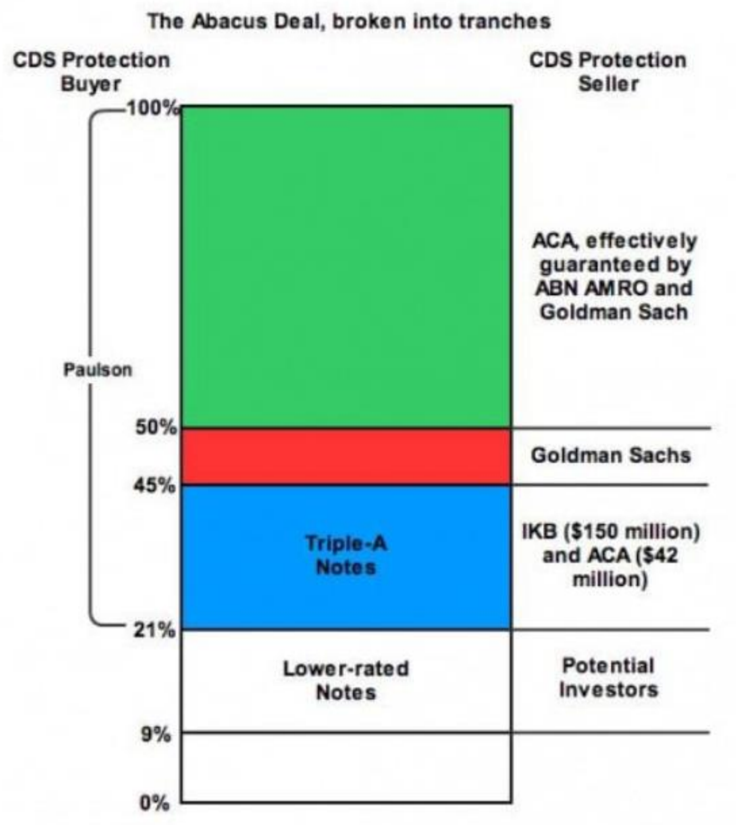
Apr 16, 2010: SEC files civil fraud charges on Goldman

Jul 15, 2010: Goldman settles for $550M; acknowledges “incomplete” marketing info; promises reforms.

2013-2014: Fabrice Tourre found civilly liable

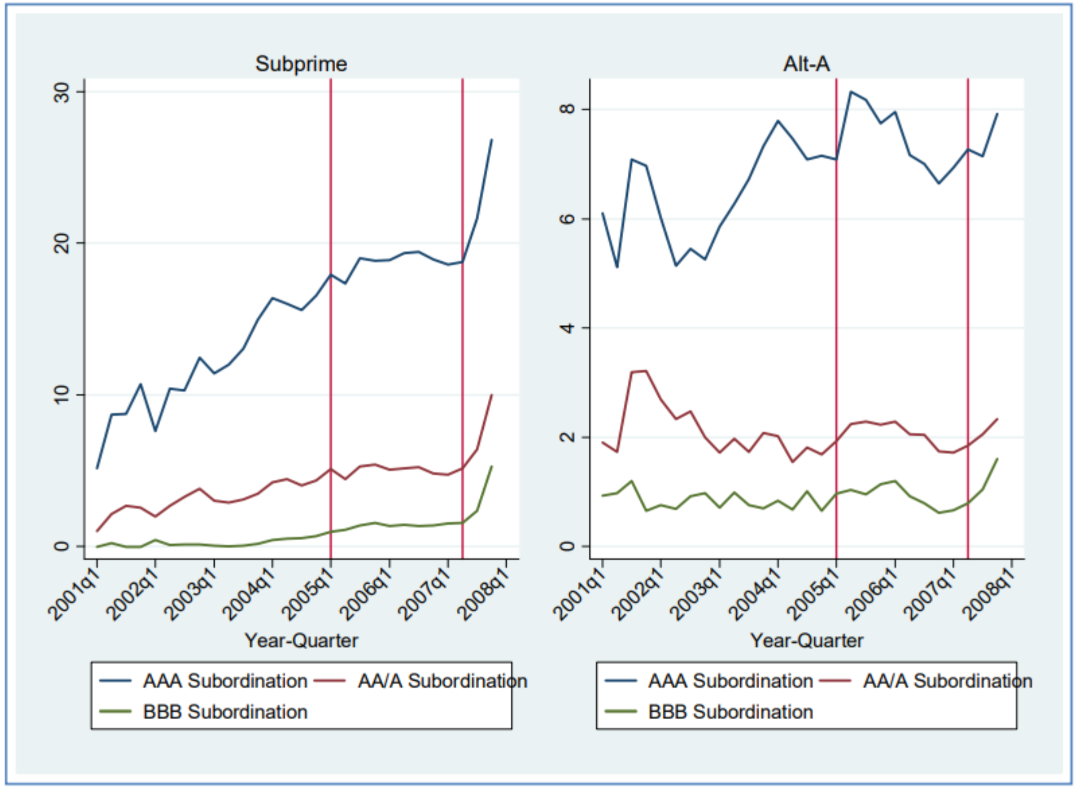
HOW ABACUS WORKED & THE CONFLICT

- **Long side** = Earned steady payments as long as bond didn't go bad
- **Short side** = Got paid if the bonds did go bad
- **What was unusual:** Paulson (short side) helped choose which bonds the deal was based on, but their influence wasn't made clear.
- **Why that matters:** Who picks the asset is a crucial fact in decision making
- **Simple analogy:** Home inspector betting on your house also writes the inspection report, and buyer isn't told



WHY IT BLEW UP (RATINGS & MARKET TURN)

- **Pre-2007**: Ratings assumed **rising home prices**, **low correlation** of defaults, and stable prepayments.
- **2006-2007**: Lending got looser; agencies asked for subordination
- **2007–08:** Those assumptions **snapped** → **home prices fell**
- Synthetic structures **amplifies losses during bad times**



IMPACT (INVESTORS, GOLDMAN, SYSTEM)

- **Investors & Trading Partners:** Longs took heavy losses; learned to demand transparency disclosures in deals.
- **Goldman Sachs:** $550M settlement; reputation took big hit, but business survived.
- **Market norms:** Banks moved key facts to the front page (who’s long/short, who picked assets, arranger’s position).
- **Bigger picture:** The case became a symbol of how complexity + opacity + incentives can turn private gain into public pain.

REFORMS & MANAGERIAL LESSONS

Reforms:

- **Volcker Rule** (keep deposit-backed banks out of house bets)
- **FSOC** (team of regulators to watch system for risk build-ups)
- **Living wills** (plan on how to fail safely)

Managerial safeguards:

- Separating and documenting who picks assets when someone bets against the deal
- Who is the long/short?
- Empowering risk and compliance to slow or stop deals

Takeaway: Complex is not evil; opaque + misaligned is. Make roles and incentives obvious.

DISCUSSION QUESTIONS

1. Who bears the most responsibility in ABACUS: the arranger (Goldman), the selector (ACA), the short (Paulson), or someone else?

2. How much disclosure is enough? If a short-side fund helps choose assets, does telling it front up fix the conflict, or is the deal still tainted?

3. What authority should Conflict Committees have (veto? disclosure edits? pricing changes?) to make a real difference?