The New York Times

April 27, 2010

OP-ED CONTRIBUTOR

Meet the Real Villain of the Financial Crisis

By BETHANY McLEAN

TODAY, we will have the pleasure of watching outraged members of the Senate Permanent Subcommittee on Investigations fire questions at a half-dozen executives from Goldman Sachs. The firm first attracted anger for its return to making billions, and paying its employees millions, right after the financial crisis. And since the Securities and Exchange Commission this month charged Goldman with fraud over an investment tied to subprime mortgages, politicians have turned the firm into the arch-villain of the economic collapse.

But the transaction at the heart of the S.E.C.'s complaint is a microcosm of the entire credit crisis. That is, there are no good guys here. It's dishonest and ultimately dangerous to pretend that Goldman is the only bad actor. And the worst actor of all is the one leading the charge against Goldman: our government.

Each of the supposed victims here was, at best, a willing accomplice. Let's start with those who bet that the investment in question, Abacus 2007-AC1, would be profitable for them: a bond insurer called ACA Capital Holdings and a German bank named IKB Deutsche Industriebank. These companies allegedly didn't know that Goldman, in exchange for $15 million in fees, had allowed a client, the hedge fund manager John Paulson, to help design the investment in order to improve the odds that it would fail.

But there was nothing hindering ACA's ability to see that mortgages sold to people who probably couldn't pay weren't great investments. Meanwhile, the company's insurance arm was covering as many subprime mortgages as it could to increase its own short-term profits. In some ways, the ACA story is the A.I.G. story: The company thought it had found free money — and basically bankrupted itself.

Similarly, the German bank advertised itself as a sophisticated investor, but didn't seem to have bothered to analyze the subprime-backed bonds it was buying. The bank just relied on the AAA rating and, not surprisingly, pretty much bankrupted itself, too.

Which brings us to the rating agencies that stamped over 75 percent of Goldman's Abacus securities with that AAA rating, meaning the securities were supposed to be as safe as United States Treasury bonds. They did the same to billions of dollars worth of equally appalling securities backed by subprime mortgages at other firms. Without the cravenness of the rating agencies, there would have been no Abacus, and no subprime mortgage crisis.

None of this excuses Goldman. Whether the transaction was legal or not, there’s a difference between what’s legal and what’s right. Goldman, where I worked at a junior level from 1992 to 1995, has always held itself up as a firm that adheres to a higher standard. “Integrity and honesty are at the heart of our business” is one of Goldman’s 14 principles. There is no way to square this principle with the accusation that Goldman did not tell a customer who didn’t want to lose money — the very definition of a buyer of AAA-rated securities — that the investment it was selling had been rigged to amplify the chances that it would, yes, lose money.

Transactions like this one open up a window into modern finance, and the view is downright ugly. This deal didn’t build a house, finance a world-changing invention or create any jobs. It was just a zero-sum game that transferred wealth from what Wall Street calls “dumb money” (often those who manage the public’s funds) to a hedge fund. It certainly belies what Lloyd Blankfein, the firm’s chief executive, told me last fall: “What’s good for Goldman Sachs is good for America.” Could the scary truth be that, at best, the success of one has nothing to do with the success of the other?

Yet, in the end, it comes down to this: Goldman Sachs, ACA Capital, IKB Deutsche Industriebank and even the rating agencies never had any duty to protect us from their greed. There was one entity that did — our government.

But it was the purported regulators, including the Office of the Comptroller of the Currency and the Office of Thrift Supervision, that used their power not to protect, but rather to prevent predatory lending laws. The Federal Reserve, which could have cracked down on lending practices at any time, did next to nothing, thereby putting us at risk as both consumers and taxpayers. All of these regulators, along with the S.E.C., failed to look at the bad loans that were moving through the nation’s banking system, even though there were plentiful warnings about them.

More important, it was Congress that sat by idly as consumer advocates warned that people were getting loans they’d never be able to pay back. It was Congress that refused to regulate derivatives, despite ample evidence dating back to 1994 of the dangers they posed. It was Congress that repealed the Glass-Steagall Act, which separated investment and commercial banking, yet failed to update the fraying regulatory system.

It was Congress that spread the politically convenient gospel of home ownership, despite data and testimony showing that much of what was going on had little to do with putting people in homes. And it’s Congress that has been either unwilling or unable to put in place rules that have a shot at making things better. The financial crisis began almost three years ago and it’s still not clear if we’ll have meaningful new legislation. In fact, Senate Republicans on Monday voted to block floor debate on the latest attempt at a reform bill.

Come to think about it, shouldn’t Congress have its turn on the hot seat as well? Seeing Goldman executives get their comeuppance may make us all feel better in the short term. But today’s spectacle shouldn’t provide our government with a convenient way to deflect the blame it so richly deserves.

Bethany McLean, a contributing editor for Vanity Fair, is writing a book about the financial crisis with Joe Nocera of The Times.