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Goldman's Lose/Lose Proposition

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Goldman Sachs ([GS](#): 153.14, -4.4, -2.79%) can't win.

Sure, the Wall Street titan accused by the government of fraud could be acquitted after a prolonged, public and pricey legal battle, but in the short term, Goldman is in an unenviable battle against the [Securities and Exchange Commission](#).

No matter the outcome of the legal fight, the SEC allegations have already done damage to Goldman's reputation, threaten to cause it to lose business and may even legitimize some of the conspiracy theories swirling around the bank.

"In the short term it's a lose/lose for Goldman," said Elizabeth Nowicki, a former SEC attorney and a visiting law professor at Boston University. "They will weather this storm but it will definitely cost them some business and credibility. They will have to be more pure than Caesar's wife."

For the SEC, the powerful message has been sent to the rest of Wall Street, perhaps even increasing the chances of Congress passing a [financial](#) reform bill. Thus, the outcome of the legal battle doesn't matter much for the SEC -- in the interim, at least.

Public Relations 'Body Blow'

Goldman's stock suffered its steepest one-day dollar decline on record last week after the SEC said Goldman -- the most profitable bank in Wall Street history -- committed fraud. The SEC is alleging that Goldman failed to notify investors in a subprime-related financial product that a hedge fund helped construct the product and was betting against it. Legal experts and analysts are split about the merits of the case, which is already playing out in a real-time court of public opinion, but the damage may already have been done.

"The real publicity here is in the charge itself. I think that's what's going to stick here," said Charles Geisst, a finance professor at [Manhattan College](#).

The risk for Goldman is not that it will now be unable to win a popularity contest. It's that the charges -- true or not -- may cause Goldman to lose business due to a lack of trust and less credibility with its clients.

"The SEC is saying Goldman's reputation is built on lies, that they take advantage of their clients. This is just a real body blow to their business model," said Gary Weiss, a columnist at [Portfolio.com](#), who wrote *Wall Street Versus America*.

Already, politicians in the U.K. and Germany, where banks lost almost \$1 billion on the financial product in question, have called for their governments to cut back on their ties to Goldman as punishment. A loss of business there wouldn't cripple Goldman but would cost it tens of millions of dollars in annual fees. (On the flip side, Goldman is widely regarded as the best in the business, and would-be customers will have to weigh the benefits of not doing business with the firm against the potential cost, whether it be in expertise, execution or something else.)

Even if Goldman prevails in its fight with the SEC, some large [pension funds](#) may have to cut back exposure to Goldman simply because of the charges of malfeasance.

"They are going to lose business one way or the other. If they lose the case they could lose a significant amount of business, which could imperil the firm," said Geisst.

Others, like Duke business professor Campbell Harvey, say it's too early to predict with certainty that Goldman will lose clients. "It's not obvious to me they are going to take a big hit in their business. A number of people may say they are just standing up" to the SEC, said Harvey.

In any case, the SEC charges only give further credence to the conspiracy theories hovering over Goldman for decade. Namely, the charges legitimize claims crystallized by *Rolling Stone* writer Matt Taibbi, who called Goldman a "vampire squid" that has been behind every major market manipulation in the U.S. since the Great Depression.

"It says all of their critics are right. Taibbi's right. Goldman Sachs really is a vampire squid," said Weiss.

Has the SEC Already Won?

For the SEC, simply filing the suit against Goldman may have already accomplished its near-term mission.

"They've made their point: Don't mess around with the SEC, don't mess around with the market," said Nowicki. "They've already won the bigger battle."

Even if the SEC loses in court, that verdict won't be rendered until long after the financial overhaul debate has ended. Already, the fraud allegations appear to have increased the likelihood reform legislation passes in Congress, completing another goal of the SEC. That line of thinking has led more than a few people to suggest the charges are politically-motivated, something the SEC and White House have flatly denied.

"I don't think the SEC deliberately timed their complaint but it's definitely influenced the discussions on financial reform. It's made clear to the holdouts there are confidence issues and there is definitely a need for reform," said Nowicki.

Reports that SEC commissioners voted by a slim, party-line 3-2 margin to file charges have also led some to say the case may not have merit and is politically-motivated.

"This smells of politics," said Harvey, noting the SEC felt the need to show it is doing something, especially in the wake of the Bernie Madoff Ponzi scheme.

However, Nowicki said the closeness of the vote could just indicate dissension on the timing of the case, not its merits. "If it were truly a weak case, the commission never would have voted on it," she said.

Meanwhile, the SEC probe could open up a Pandora's Box of other shady practices. The SEC has said the probe won't be limited in scope to the specific allegations and future depositions and subpoenas during discovery could shed a negative light on the bank.

"The SEC investigation may very well turn up even more serious things -- maybe criminal conduct," said Weiss. "This will be the No. 1 priority at the SEC. When the SEC is motivated, which is rare ...they can really bear down on a company."

All of this doesn't mean both sides don't have something to gain in the long haul. If the SEC loses a case against Goldman, it may embolden other Wall Street banks and signal that it can be beaten. It could also make the agency more hesitant to file charges in the future.

So does that mean it's in both sides' interests to settle? Experts are split, with some saying Goldman has no choice but to fight the charges and others saying it must settle. Stay tuned.

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