Incite - Four bizarre myths about the Goldman settlement

Despite reports to the contrary, the Wall Street giant can't say it dodged the F-bomb in its deal with the SEC

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While the Securities and Exchange Commission's fraud lawsuit against Goldman Sachs may be over, the myths about what's contained in the settlement agreement seem to have taken on a life of their own.

There's been so much bizarre misinformation floating around on this subject that it's time to set the record straight. Contrary to many reports over the past week, the SEC did not back off any of its fraud allegations. Nor will Goldman be allowed to deny the SEC's harshest accusations. Yet oddly, articles and analyst reports keep popping up asserting otherwise.

To recap, the SEC's lawsuit accused Goldman and a vice president, Fabrice Tourre, of making false and misleading statements to investors about a synthetic collateralized debt obligation that was designed to fail, called Abacus 2007-AC1. The SEC said the firm's main offense was telling the German bank IKB that a company called ACA had selected the portfolio of mortgage-related investments underlying the deal, when actually the selection process was heavily influenced by Paulson & Co., a hedge fund that later made $1 billion shorting Abacus.

The SEC made two sets of claims in its complaint alleging that Goldman and Tourre intentionally committed fraud, i.e., the F-bomb. The first fell under a section of the Securities Act of 1933 called 17(a). The second was under the better-known Section 10(b) of the Securities Exchange Act of 1934 and an accompanying rule known as 10b-5, which, like 17(a) and 10(b), prohibits fraud in the sale of securities.

Goldman settled the case without admitting or denying the commission's allegations, which remain unproven. Tourre is contesting the SEC's claims.

With that backdrop, here are some of the strange myths that have found their way into the media food chain lately, and the reasons why they are bunk.

Myth No. 1: The SEC's fraud allegations against Goldman have evaporated.

Not true -- and then some. The judgment order in the case says Goldman "consented to entry of this final judgment without admitting or denying the allegations of the complaint." It didn't strike any of the complaint's allegations. Neither did Goldman's consent decree. Nor did the SEC amend its April 16 complaint.

The upshot: The SEC did not withdraw any -- I repeat, not any -- of its fraud allegations against Goldman.

Myth No. 2: The SEC dropped its 10(b) fraud claim as part of the settlement.

This remarkable work of fiction seems to stem from the fact that the injunction in the judgment order permanently bars Goldman from violating 17(a) in the future, but doesn't contain any reference to 10(b). (The injunction, in effect, places Goldman on probation with the SEC.)

The reality is that the SEC's complaint still contains an unadjudicated accusation that Goldman violated 10(b). The injunction is part of the remedy in the case, not part of the SEC's allegations -- which remain unchanged. Had the SEC stricken the 10(b) claim from its complaint, Goldman would have been allowed to deny it violated this section of the law. However, the SEC didn't do this.

As for why the SEC agreed not to mention 10(b) in its proposed injunction: it wasn't necessary.

The biggest difference between the two sections is that 17(a) prohibits fraud in the sale or offer of securities, while 10(b) prohibits fraud in the sale or purchase of securities. The Goldman suit was about sales, not purchases.

The SEC gave up little to nothing in substance by agreeing to leave 10(b) out of the injunction. What is more, the 17(a) injunction covers both intentional and negligent violations. The only victory here for Goldman was a symbolic one, if that.

Myth No. 3: The settlement points toward negligence, not fraud.

Come on, this one isn't even close. Again, the SEC's complaint alleged intentional fraud violations under both 17(a) and 10(b). And while it's true that Goldman took the unusual step of acknowledging “a mistake” as part of the accord, for failing to disclose Paulson's role in selecting the investments in the Abacus portfolio, that doesn't mean the SEC downgraded all of its fraud allegations to mere negligence.

Myth No. 4: The settlement allows Goldman to deny the SEC's accusation that it intentionally committed fraud.

Wrong, and absurdly so. Under its deal with the SEC, Goldman agreed “not to take any action or to make or permit to be made any public statement denying, directly or indirectly, any allegation in the complaint or creating the impression that the complaint is without factual basis.”

This agreement applies to both the 17(a) and 10(b) claims. That's why both sets of fraud allegations will continue to live on in some form after the suit's resolution. If Goldman were allowed to deny any of the SEC's claims, it would. It isn't doing that, because it can't.

The reason all of this is important is that it goes to Goldman's reputation. The bottom line in this case, which Goldman is paying $550 million to resolve, is that the SEC leveled the most serious fraud allegations it could against Goldman. And rather than fighting to defend its good name and exonerate itself, Goldman settled and agreed to let the SEC's claims remain uncontested.

Whether you think the SEC won, there's no doubt Goldman lost. This is one stain that won't come off easily.

(Jonathan Weil is a Bloomberg News columnist. The opinions expressed are his own.)