UCCS College of Business
UNIVERSITY OF COLORADO COLORADO SPRINGS

Goldman Sachs: The Greek Situation

Introduction

In criminal law, fraud is "the act of intentional deception made for personal gain or damage to another individual" (Def. 1). In the past few decades, many individuals have been caught in this fiendish act, and far more have been victimized. Since a handful of infamous instances in the early 2000's, our nation's economic system has been able to monitor and deter most fraudulent activities. However, there are still loopholes in the system allowing individuals to manipulate and exploit countless investors.

When the culprit is a financial advisor, "it's difficult for the customer to determine who to listen to and who to trust," (Ruiz 2012). When the victim is a nation, it can be difficult to appreciate how many people and institutions will feel the repercussions. Goldman Sachs doctored the books for an entire nation and made a huge profit doing so. Then this firm essentially left the nation in an exponentially more torrential sovereign debt crisis, using "what can legitimately be called 'financial wizardry'," (Arghyrou and Tsoukalas).

Overview

Somewhere between the end of 2000 and mid 2001 the American investment bank and Wall Street giant, Goldman Sachs (GS), facilitated several intricate transactions with Greece. These transactions employed trading methods utilizing elaborate financial derivatives (particularly security swaps) with the purpose of concealing Greek national debt. The Hellenic Republic of Greece was the newest member of the Eurozone at the time.

In order to remain in the European Union (EU), a nation must meet and uphold financial policies per the Maastricht Treaty. The two limits imposed on government finances were the following: "3% for the ratio of the *planned or actual* government deficit to gross domestic product [GDP] at *market prices*," and "60% for the ratio of [total] government debt to gross domestic product [GDP] at market prices" (TEU 1992, emphasis added). In an effort to hide Greece's swelling public debt from EU regulators (in 2009 debt to GDP ratio was 130%), Goldman Sachs implemented over-the-counter (OTC) trades—private trades occurring outside any regulated securities exchange. These trades involved exchanges of

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derivative contracts (swaps) between GS and Greece. In short, Goldman Sachs succeeded in avoiding EU scrutiny by giving Greece an off-the-books loan.

Greece's publicly reported deficit/debt ratios were artificially reduced in 2001 by effectively issuing the country an upfront 'cash-advance,' through the use of cleverly crafted swaps by Goldman Sachs, at a time when such a 'loan' was not required by Eurostat to be reported as a liability. Therefore, the unconventional pseudo-loan was not only kept off the public books, it was also explicitly used to write-down the existing sovereign debt load as though the funds were in fact surplus government revenue (Ruiz 2012).

Since these swaps and loans were kept off the books, no higher entity could crosscheck the methods or numbers used by Goldman Sachs. The swaps implemented were cross-currency swaps (CCSs) which GS specifically engineered with fictitious exchange rates. This gave the deal a lure of profitability and a guise of stability to the Hellenic Republic.

These tactics may have given Greece the appearance of an improving financial position (required by the Maastricht Treaty for membership in the Eurozone), but they essentially created a house of cards that could only stand for so long. Goldman Sachs, which handled the whole deal and ultimately profited from extensively, creatively "engineered" a worthwhile process to repay the loan. This too, was concealed from the EU by use of a swap.

The next, and possibly most important thing to recognize, is where the money for this "loan" came from. GS purchased a $1 billion insurance policy, for the duration of its IRS contract with Greece, from a German investment bank, Deutsche Pfandbriefe Bank (DEPFA), whose interest was in making profit by holding sovereign debt risk (Dunbar 2003). This was considered a currency default swap (CDS) and was intended to protect GS from a Greek default on the loan. The insurance was in the name of Goldman Sachs under another bank, thus freeing up the usable capital of GS. In exchange for DEPFA's promissory

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note, GS agreed to pay a monthly premium to DEPFA. This is standard practice, except in this instance, GS artistically made Greece take over payments for it through the complex nature of the deal.

Current Situation

Goldman Sachs, while secretly masking sovereign debt and the true conditions of the Hellenic Republic, underwrote Greece's government bonds and sold them to investors globally. This managed to give Greece a €15 billion profit, and rewarded GS with $24 million from the sales. Further, the IRS contract GS had developed initially yielded €2.8 billion, including a €400 million fee, both to go to Goldman Sachs. The investment bank then sold the entire package back to Greece, for a price of €5.1 billion (twice its original value of €2.4 billion).

Regulators of the EU have begun investigations to reveal the nature of Greece's skyrocketing debt and the involvement of Goldman Sachs. "Eurostat's report not only clarified the 'legality' behind the activities of Goldman Sachs and Greece, but more importantly, it identified its underlying logic—the whole affair, we are told, must be 'seen as a part of a single global arrangement' fostered by the euro area. I couldn't agree more," (Ruiz 2012).

As Greece loses more and more financial foothold (sovereign debt totaling €300+ billion), its membership in the Eurozone continues to be skeptical at best. Eurostat regulators fear that if Greece is forced to exit the Eurozone, it will begin a domino effect for many other struggling nations in the Eurozone (PIIGS: Portugal, Italy, Ireland, Greece**,** and Spain), and the strength of the euro will decline dramatically, possibly forcing the currency itself and the Eurozone to come to a close.

Goldman Sachs has not faced any fines or lawsuits, and is at risk for no foreseeable consequences for its involvement in this sovereign debt crisis.

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Case Problem

Financial investment is notorious for being risky. Despite the legality of Goldman Sachs' actions (fictitious exchange rates, doctoring of books, shady transfer of insurance policy payments), did GS act in a way expected of a company which pledges "our clients' interests always come first. Our assets are our people, capital and reputation," (Whitehead and Weinberg)?

1. Did Goldman Sachs act with transparency in the deal?
2. Did Greece act with transparency in the deal?
3. Did Goldman Sachs place profit over the well-being of its client (in this case, a nation)?

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