

# ***SWOT Analysis of ABACUS Transaction on Goldman, Sachs & Co.***

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**Abstract:** The ABACUS deal involving Goldman Sachs was a significant event with profound consequences for Goldman Sachs and far-reaching implications for the financial industry. This paper will primarily analyze the impact of the ABACUS deal on Goldman Sachs and demonstrate the application of SWOT analysis in case studies. The entire paper will be divided into three sections according to the subheadings, with each section progressively building upon the previous to substantiate the viewpoints mentioned in the following paper. In the introduction section, the paper provides readers with a transaction overview, including the background, key players, and regulatory responses of the ABACUS Scandal, giving them a preliminary understanding of the research subject. Following that, the paper presents the process of demonstrating the internal and external impacts of the ABACUS Scandal on Goldman Sachs using the SWOT analysis, including considering the strengths, weaknesses, opportunities, and threats of the event. Lastly, the paper will summarize the findings regarding the aforementioned issues in the conclusion section, along with reviewing some shortcomings and limitations concerning research approaches, logical coherence, and other aspects. At the end of the paper, you will see both positive and negative effects on Goldman Sachs throughout the ABACUS deal from four aspects: strengths, weaknesses, opportunities, and threats.

**Keywords:** ABACUS 2007 AC1, Goldman, Sachs & Co., Paulson & Co., ACA Management

## **1. Introduction**

In early 2007, the collapse of the subprime mortgage market was the early indicator of the financial crisis of 2007, which was triggered by the shortfall of liquidity in the U.S. banking system. Subprime loans [1] were regarded as one of the riskiest credit classes in the mortgage industry since Subprime borrowers were primarily those who did not meet the requirements for traditional lending or were characterized by undesirable financial metrics. Due to the abundance of credit available at historically low rates and loose mortgage underwriting criteria in the early to mid-2000s, it was extra easy for subprime borrowers to secure financing and most of them chose to invest in housing. A bubble was successfully created as the house price skyrocketed but departed from its genuine underlying worth, and the collapse of the subprime mortgage market was the primary consequence of this bubble.

In no time, when the US housing market and associated assets were starting to show indications of concern, Goldman, Sachs & Co. was founded by Paulson & Co. to assemble a synthetic collateralized debt obligation (“CDO”) [2] called ABACUS 2007-AC1, in exchange for \$15 million

fee. This synthetic CDO [3] constructed and issued by Goldman refers to a reference portfolio consisting of subprime residential mortgage-backed securities ("RMBS") [4] obligations and was linked to the performance of RMBS. According to the Securities and Exchange Commission's (SEC) complaint, Paulson intended to short the risky mortgage bonds, which were effectively repackaged subprime mortgages using derivatives. These bonds were given a rating of "BBB," indicating that they would suffer the most when home loans fell behind on payments.

This was the setting and beginning of the ABACUS deal that would cost Goldman so dearly and even ripple through the financial markets. In the following paper, SWOT analysis will be used to analyze the impact of this significant event on Goldman in detail, aiming to learn and reflect on some strategies and behaviors of investment banks through these impacts.

## **2. The SWOT Analysis of ABACUS Deal Involving Goldman Sachs**

In the following section, SWOT analysis [5] will be applied to analyze the impact of the ABACUS deal on Goldman Sachs from different aspects. SWOT stands for Strengths, Weaknesses, Opportunities, and Threats, representing four main aspects when observing and analyzing a subject. SWOT analysis is a tool to help you better understand your business, assessing four aspects of the company and examining both internal and external factors.

### **2.1. Strengths**

Synthetic CDO is known as a complex financial instrument comprised of credit derivatives. In this case, the synthetic CDO dubbed ABACUS 2007 AC1 is assembled and issued by Goldman, Sachs & Co.. It is comprised of a large proportion of RMBS and a small proportion of low-risk obligations. Throughout the elaborate repackaging done by investors like Goldman Sachs, the originally high-risk RMBS can be skillfully converted into lower-risk CDOS and put into the market. ABACUS 2007 AC1 is a prime example of Goldman's skill and experience as an investment bank in creating and marketing complex financial products.

Financially speaking, Goldman was paid \$15 million for accepting Paulson's trust about ABACUS 2007 AC1. A benefit to Goldman is that the advantages are visible in the company's financial statements.

On the other hand, the ABACUS deal did not only demonstrate Goldman's ability to construct and repackaging complex financial products but also proves Goldman's significant global influence and critical position in the financial industry due to the mass exposure by news and media. In addition to the negative effect brought by the exposure, the news and reports provided Goldman with free chances to draw new clients and partners. When a business is struggling, it tends to attract partners that are of a higher caliber and more committed to the business.

While the ABACUS deal brought humiliation to Goldman Sachs, we can learn a lesson from that. Factually, it also made several firm issues, such as ethical issues, communication issues, internal compliance issues, etc., publicly visible. This scandal provided Goldman, a great business with a long history and solid reputation in the industry, with a great chance to recognize and address its issues which they were not aware of in the past. In this way, they can advance further and gain much more motivation to improve themselves. In a way, the scandal can be advantageous for Goldman Sachs.

### **2.2. Weakness**

According to the complaint of the Securities and Exchange Commission(SEC) [6], "The Commission brings this securities fraud action against Goldman, Sachs & Co. ("GS&Co") and a GS&Co employee, Fabrice Tourre ("Tourre"), for making materially misleading statements and omissions in connection with a synthetic collateralized debt obligation ("CDO") GS&Co structured

and marketed to investors.”. The company's image is severely damaged globally as a result of this exposing Goldman's client fraud conduct. Theoretically, a synthetic CDO's product can be composed of 80%–90% RMBS, paired with 10%–20% low-risk assets (such as corporate or municipal bonds). The original goal of such a CDO is to lower the risks of the product and improve its bond rating. In terms of bond rating, it rates [7] from low risk to high risk as “AAA”, “AA”, “BBB”, and “BB”... Notably, CDOS has one more rating than RMBS called “equity”, which presents the highest risk. Certain investment banks, including Goldman, conspired with rating agencies such as STANDARD & POOR’S and MOODY’S to bundle certain poorly rated RMBS into CDOS with higher ratings. For instance, CDO-certified “AA” or even “AAA” may include RMBS that are initially rated “BBB” along with other low-risk obligations. Morally speaking, such a method is unethical because the corporation can alter the product's actual risk assessment by packaging, therefore, skewing investors' perceptions.

Due to all Goldman’s marketing materials for ABACUS 2007-AC1, the reference portfolio [8] of RMBS underpinning the CDO was selected by ACA Management LLC (“ACA”) [9], a third party with 30 dedicated credit and portfolio management professionals with an average of 13 years relevant experience. However, Paulson, who played a key role in the portfolio selection process but with economic interests hostile to investors in the ABACUS 2007-AC1, was not mentioned in the marketing materials at all and was unknown to investors. Based on this information, Goldman’s marketing materials for ABACUS 2007-AC1 were considered false and deceptive in their representation that ACA selected the portfolio. What’s more, Paulson was shorting the securities, but Goldman never informed ACA or other investors of this information. The contact emails between Goldman and ACA did not mention a word about the relationship between ABACUS CDO and Paulson. Thus, ACA thought Paulson intended to acquire some of the riskiest components of the securities, according to the complaint [10].

As an investment bank that prioritizes the clients and values integrity, such behaviors of defrauding clients and investors are against the company's philosophy and industry ethics. The company's reputation was severely tarnished, resulting in a decline in its stock price and a loss of trust from investors and clients. Legal repercussions ensued, with Goldman Sachs facing regulatory investigations and settlements involving significant fines and compensation.

Client confidence has been damaged as a result of Goldman's lack of openness and transparency. The client does not grasp the product specifically because the corporation is not upfront with them. Finally, investors could make choices that are contrary to their initial goals because they lack sufficient product knowledge. Clients' trust in a business may indeed be significantly impacted by a lack of openness and transparency. In addition, the problem regarding communication between Goldman and its clients was exposed as well. The failure to adequately explain the financial products to the clients or the failure of making the company and the clients agree on the financial product led to the ultimate disagreement between both sides.

### 2.3. Opportunities

As a result of the ABACUS deal, Goldman Sachs learned a valuable lesson about how to package and market complex financial products, which may have led to reflection on the shortcomings of earlier efforts and brought inspiration. This crisis has also given Goldman additional knowledge and caution in many areas, enabling it to avoid mistakes in the future.

Internal compliance issues at Goldman, including communication and risk management issues, were made public by the scandal. Goldman may tighten internal compliance controls, enhance the procedures for selling products and disclosing information, and enhance consumer interaction. Additionally, businesses may take advantage of the chance to be moral and open, improve their social responsibility efforts, improve reputation management, and regain investor and consumer confidence.

Given the ethical issues revealed in the abacus scandal, compliance requirements and scrutiny from relevant regulators and examiners will undoubtedly increase. There is a chance for the entire industry, including Goldman, to take part in this reform and help improve transparency and compliance across the industry.

## 2.4. Threats

Due to the ABACUS 2007 AC1 disclosures, Goldman's past involvement in the creation and sale of complex financial products may be called into question, and the creation of such products in the future may also be subject to more scrutiny, both of which increase the risk exposure.

In ABACUS deal, Goldman served two clients on the opposite sides of the same deal [11]. It helped Paulson to assemble synthetic CDOs, and sold CDOs to Deutsche Industriebank AG (IKB). A financial institution is unlikely to perform honestly and equally for all sides in a contract when it is simultaneously serving two masters. First of all, one party always stands to earn more financially than the other. The amounts of money involved are frequently excessively high. Second, the financial institution often values some customer relationships more than others due to previous performance and anticipated future performance from those clients. Therefore, even while the organization isn't now overly vulnerable, serving two masters at once can pose a risk and cause harm.

Besides, the negative effects of ABACUS deal are considerable and long-lasting due to its extremely terrible character. Goldman Sachs could eventually be subject to investigation, litigation, and compensation. In addition, a company's reputation cannot be restored overnight, and the effects of this controversy may last for decades or even longer, posing a difficult danger to the company's future growth.

## 3. Conclusion

The paper discusses the SWOT analysis of the ABACUS transaction involving Goldman Sachs. It analyzes both the positive and negative impacts of the ABACUS deal on Goldman Sachs using the SWOT framework. The strengths of the deal include the skillful repackaging of high-risk assets into lower-risk CDOs by Goldman Sachs and the financial benefits gained by the company. The weaknesses revolve around the misleading representation of the product's risk assessment and the lack of transparency in marketing materials. The opportunities arising from the deal include learning from past mistakes, enhancing internal compliance controls, and participating in industry-wide reforms. The threats include increased scrutiny of complex financial products, potential legal repercussions, and the risk of serving conflicting interests in a transaction.

While this paper provides insights into the ABACUS transaction and its impact on Goldman Sachs, there are some limitations and shortcomings. Firstly, the paper does not provide a comprehensive analysis of the regulatory responses and the broader implications for the financial industry resulting from the ABACUS deal. Secondly, the paper needs more authoritative references to enhance the accuracy, authenticity, and professionalism of the information provided by the paper. Lastly, the article lacks a balanced discussion of the perspectives and arguments of different stakeholders involved in the ABACUS transaction, which could provide a more comprehensive understanding of the event.

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