Goldman to Pay Up to $5 Billion to Settle Claims of Faulty Mortgages

By MATTHEW GOLDSTEIN    JAN. 14, 2016

More than seven years after the worst of the financial crisis, Goldman Sachs is again paying a price for the role it played.

The Wall Street firm said on Thursday it had agreed to a civil settlement of up to $5 billion with federal prosecutors and regulators to resolve claims stemming from the marketing and selling of faulty mortgage securities to investors.

Goldman announced the settlement — the final terms of which are still being negotiated — after the markets closed.

Goldman, which is scheduled to report fourth-quarter earnings on Wednesday, said the settlement would reduce earnings in that period by approximately $1.5 billion on an after-tax basis.

In the early days of the financial crisis, Goldman Sachs received an outsized share of criticism from politicians and the media as its trading desk made money by betting against the housing market in the run-up to the crisis.

But in the end, Goldman’s role in churning out faulty mortgages and
securities backed by home loans to borrowers who could not afford them was smaller than that of many other Wall Street firms like Bank of America or JPMorgan Chase.

As a result, Goldman’s settlement is far smaller than the sums paid by other firms for selling flawed mortgage securities. Goldman is among the last firms to reach a civil settlement with a task force of federal prosecutors, state attorneys general and regulators empowered to investigate Wall Street’s role in cobbling together securities from all the mortgages that borrowers found themselves unable to afford.

The agreement in principle requires Goldman to pay $2.385 billion in civil penalties and $875 million in cash and provide up to $1.8 billion in relief to consumers.

Bank of America in 2014 paid about $16.6 billion in a similar settlement with federal and state agencies, and JPMorgan Chase paid about $13 billion in 2013. In all, the banks have paid more than $40 billion in settlements to resolve claims investigated by the task force.

All the mortgage settlements have included a certain amount of so-called soft money that is intended for loan modifications or foreclosure relief for consumers harmed by the bad mortgages. Some consumer advocates have raised concerns about how that money is allocated and how much comes directly from each bank’s bottom line. In the case of Goldman, the soft money is the $1.8 billion.

In the case of Bank of America, the soft dollar portion of its settlement totaled about $7 billion. But Bank of America was involved in writing far more mortgages to consumers than Goldman Sachs, and it is unclear exactly how Goldman’s consumer relief will be doled out and to whom.

The settlement is on top of the approximately $3 billion Goldman paid to the Federal Housing Finance Agency in 2014 to settle claims with Fannie Mae and Freddie Mac over the sale of flawed mortgage securities. In that
deal, Goldman settled the matter by buying back bonds from the mortgage finance firms.

In 2010, Goldman paid $550 million to the Securities and Exchange Commission for its role in putting together a collateralized debt obligation called Abacus. That bundled deal of subprime mortgage securities resulted in losses to investors. But the so-called synthetic C.D.O. was constructed in such a way as to allow another investor to profit by shorting, or betting against, the mortgage securities that were packed into the investment vehicle.

The settlement in principle that Goldman announced on Thursday did not involve C.D.O.s, but more traditional mortgage-backed securitizations.

The deal resolves claims arising from Goldman’s underwriting and sale of mortgage-backed securities from 2005 to 2007, during a period leading up to the financial crisis and a sharp decline in home prices across the country.

In announcing the settlement now and including the cost in the fourth quarter, Goldman is trying to enter 2016 with a clean slate and put much of its outstanding regulatory issues behind it.

In the short term, the settlement could greatly affect the fourth-quarter earnings that Goldman reports next week. In the third quarter, the firm reported a profit of $1.3 billion, or $2.90 a share.

Shares of Goldman rose 1.5 percent to $161.39 on Thursday.

“We are pleased to have reached an agreement in principle to resolve these matters,” Lloyd C. Blankfein, Goldman’s chairman and chief executive, said in a statement.

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