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SCOTT SIMON, host:

This is WEEKEND EDITION from NPR News. I'm Scott Simon.

Wall Street is reeling from fraud charges leveled against Goldman Sachs by the Securities and Exchange Commission. In a civil suit filed yesterday, the SEC alleges the giant bank created and sold mortgage investments it knew were shoddy and likely to collapse.

NPR's Wendy Kaufman reports on the federal government's first major enforcement action stemming from the subprime mortgage crisis.

WENDY KAUFMAN: The complaint alleges a scheme that worked like this: Goldman created a mortgage investment deal at the request of John Paulson, a hedge fund manager who made billions betting the real estate market would tumble. Goldman let Paulson select mortgage bonds that were likely to go sour and packaged them into investments. But the foreign banks, pension funds and others who bought them were not told of Paulson's role, nor were they told that Paulson was betting against the investment.

Professor JILL FISCH (University of Pennsylvania Law School): These are pretty egregious facts in terms of the scope of the fraud.

KAUFMAN: Jill Fisch is an expert in securities regulation at the University of Pennsylvania Law School.

Prof. FISCH: According to the allegations, Goldman was manufacturing a product that it knew would fail and selling that product to investors, and that goes a lot further than the role weve understood the investment banks to have played.

KAUFMAN: Investors lost more than a billion dollars while Goldman and Paulson profited. Paulson was not charged with fraud, but one Goldman executive was: Fabrice Tourre. He allegedly played a major role in structuring and marketing the investment.

In emails obtained by the SEC, Tourre was boastful. The whole building - he wrote in French - is about to collapse any time now. Only potential survivor: the Fabulous Fab - standing in the middle of all these complex, highly leveraged exotic trades he created without necessarily understanding all the implications of those monstrosities. Three exclamation marks followed.

Yesterday, Goldman Sachs released a statement saying the SEC's charges are completely unfounded in law and fact and the company would vigorously contest them and defend the firm and its reputation.

Earlier this year, the firm's chairman, Lloyd Blankfein, responded to questions not about this case but about the way Goldman marketed mortgage-backed securities. The questioner was Phil Angelides, chairman of a federal panel investigating the causes of the financial crisis.

(Soundbite of recording)

Mr. PHIL ANGELIDES (Chairman, Financial Inquiry Commission): Was your due diligence adequate?

Mr. LLOYD BLANKFEIN (Chairman, Goldman Sachs): Well, that could be...

Mr. ANGELIDES: I mean did you scour loan tapes? I guess at what point do you have a responsibility? What is the sense of responsibility?

Mr. BLANKFEIN: Well, we have a responsibility to be open and to tell people what they're having.

KAUFMAN: Some analysts believe that government could have a difficult time proving that Goldman wasnt open and honest, in part because of the way the bonds were selected.

Nonetheless, Brad Simon, a former federal prosecutor who now defends companies accused of white collar crime, says Goldman should be worried about the SEC matter and about a possible criminal prosecution.

Mr. BRAD SIMON (Former Prosecutor): I would be very concerned if I were Goldman. The fact pattern as it's been outlined in the SEC complaint is really quite extraordinary. They're so bent on making profits any way they can that they're actually putting their own clients at risk.

KAUFMAN: Whatever happens in the Goldman Sachs case, the spotlight will remain on Wall Street bankers, as Congress considers tougher regulations for financial institutions.

Wendy Kaufman, NPR News.