SEC Questions ‘Not Us’ Firm

Executives of Investment Company Had Rejected Goldman Deal as Too Risky

BY GREGORY ZUCKERMAN
AND SERENA NG

The Securities and Exchange Commission in recent weeks has questioned executives of a little-known firm that played a key role in the business of arranging mortgage investments, as part of the agency's probe into now-controversial deals struck at the height of the housing bubble.

GSC Group Inc. was one of several firms that helped banks, including Goldman Sachs Group Inc., put together deals that allowed investors to bet on the housing market.

The New Jersey investment firm turned down Goldman’s request to select assets for the debt deal at the center of the agency’s fraud lawsuit against Goldman, according to a person familiar with the matter and an email released by a Senate subcommittee this week. The concern: The deal was too risky for investors, according to the person and the email.

GSC received a subpoena from the SEC last summer and held subsequent discussions with the agency, including in recent weeks, according to an executive at the firm.

“GSC’s involvement here is strictly as a witness, and we’re cooperating with the SEC,” said Daniel Ross, a lawyer for the firm.

A spokesman for the SEC declined to comment. Goldman and an employee on the deal who also was sued, Fabrice Tourre, have denied wrongdoing.

GSC was founded in 1994 as Greenwich Street Capital Partners Inc., a private-equity unit of Travelers Group. In 1999 it became an independent company and now goes by GSC.

GSC, which manages about $8 billion, counts among its senior investment professionals five Goldman alumni, including GSC’s chief executive and chairman, Fred Eckert. Goldman regularly offered GSC a chance to work on its debt deals earlier this decade, according to someone close to the matter.

A representative of GSC said, “Please turn to page C3.”

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executives who ran the firm’s mortgage unit didn’t come from Goldman and the unit didn’t have a special relationship with the bank.

A Goldman spokesman said the firm had no comment.

In January 2007, Goldman bankers approached GSC to select mortgage-backed securities for a complex deal known as a synthetic collateralized debt obligation that it was creating at the behest of hedge-fund manager John Paulson. At the time, Mr. Paulson was bearish on the mortgage market, according to an email released this week by a Senate subcommittee questioning Goldman executives and according to the SEC complaint. GSC turned away the business.

“As you know, a couple of weeks ago we had approached GSC to ask them to act as portfolio selection agent for that Paulson-sponsored trade, and GSC had declined given their negative views on most of the credits that Paulson had selected,” said the email, from Mr. Tourre in late-January 2007. Goldman eventually tapped ACA Management LLC to select the securities for the deal, which was named Abacus 2007-AC1. The SEC alleges Goldman and Mr. Tourre didn’t inform investors that Mr. Paulson’s firm, Paulson & Co., played a role in picking the assets and that Goldman and Mr. Tourre misled ACA about Paulson’s position.

The deal quickly lost value, leading to investor losses in excess of $1 billion and gains to Paulson of about $1 billion.

GSC worked with Goldman on a $1.6 billion mortgage-linked deal called GSC ABS Funding 2006-3g that closed in January 2007. GSC also was involved in Anderson Mezzanine Funding 2007-1, a $307.5 million mortgage-linked CDO underwritten by Goldman in March 2007 that soured quickly after it was sold, according to documents released by the Senate subcommittee.

GSC agreed to manage the collateral of several mortgage-linked CDOs that hedge fund Magnetar Capital had input on from 2006 to 2007, according to documents reviewed by The Wall Street Journal and people familiar with the matter. Magnetar purchased a risky ‘equity’ slice of these and other CDOs overseen by third-party managers and bought credit default swaps on other parts of the same CDOs or similar deals that would help Magnetar profit in a housing downturn.

Those deals also tumbled in value.

A spokesman for Magnetar declined to comment.

GSC stopped helping create new mortgage CDOs two years ago amid a downturn in the market, according to the firm.
For Employees, Concern and Shots

By Kati Kelly

Goldman Sachs Group Inc's thrashing in Washington left many employees angry, some discouraged and others worried their email and other internal documents could be snatched by regulators and investigators.

"Let me remind you that we should anticipate continued external focus on Goldman Sachs for the foreseeable future," Goldman Chairman and Chief Executive Lloyd Blankfein said in a voice-mail message to employees after what he described as a "rigorous" hearing by the Senate Permanent Subcommittee on Investigations on Tuesday.

"Please do not let this distract you from your daily responsibilities," he said.

Some employees of the New York company told each other how unfair it seems to them that Goldman is being singled out for betting against the housing market in 2007 as it was pitching mortgage-backed bonds to certain clients. Many other Wall Street firms did the same thing but escaped the relentless, nearly 11-hour pummeling Goldman got.

According to employees, Goldman managers have urged them to keep a low profile, think carefully about the restaurants and parties they attend and watch how they behave in public. Some employees are even reluctant even to go out to lunch with co-workers for fear of being overheard talking about Goldman, said one person familiar with the matter.

On Wednesday, Goldman employees still were sizing up the performance of Mr. Blankfein, accused trader Fabrice Tourre and other current and former executives who testified before the Senate panel.

Not Apologetic Enough?

Some people at the firm said Mr. Blankfein seemed insufficiently apologetic, focusing too much on Goldman's role as a trading operation and not enough as a trusted underwriter of securities sold to clients.

A Goldman spokesman declined to comment.

Goldman employees can take heart that stock-market investors were apparently pleased with its executives' performance in front of Congress. Goldman shares rose 3.3% over the past two days, making them the best performing financial shares in the Standard & Poor's 500 stock index.

One particularly shocking disclosure to Goldman's current mortgage traders, according to one of them, came in the employee performance reviews that were unearthed by the Senate committee. Some traders wondered aloud if their own internal communications would remain private.

Traders, including those in the fifth-floor mortgage division of Goldman's headquarters at 200 West Street in lower Manhattan, have been reminded by their bosses to stay focused and keep doing business as usual despite all the distractions, according to people who heard the remarks.

Poring Through Email

Before Tuesday's hearing, Jeffrey Verschleiser, one of Goldman's mortgage-division heads, spent days poring through email and other documents to help executives prepare for their testimony, said people familiar with the matter. Other employees in the group assisted.

As the hearing dragged on, employees and alumni fired text messages, emails and instant messages back and forth about the group's performance. One Goldman employee said he was invited to tag along with a group of traders who said they were heading to a bar to watch Mr. Blankfein's testimony.

He said they joked that they planned to down a shot of liquor every time the CEO used the word "synthetic," a reference to the type of collateralized-debt obligation for which Goldman has been accused of fraud by the Securities and Exchange Commission.

Goldman denies any wrongdoing.

—Carolyn Cui

and Joe Bel Bruno

contributed to this article.
The Tourre
Exception?
Release of His Emails
Led to Pointed Questions,
But Not Many Answers

BY MICHAEL COBERTY

There was a lot to digest from the 10-hour-plus grilling endured by Goldman Sachs Group executives Tuesday, and the media's coverage was fairly encyclopedic.

But one line of questioning that doesn't seem to capture much attention is Sen. Tom Coburn's probing into why Goldman publicly released the emails of Goldman trader Fabrice "Fab" Tourre.

The Oklahoma Republican raised the issue early in the hearing, asking the Goldman executive how it made him feel that his employer had released his emails. Mr. Tourre refrained from any criticism of Goldman action, but he seemed rattled by the question.

The senator went on to point out that Goldman not only provided reporters with Mr. Tourre's emails, but also with English-language translations of the documents. (Mr. Tourre's first language is French.)

Mr. Coburn never accused Goldman of seeking to set up Mr. Tourre as a scapegoat, but the line of questioning seemed to suggest Mr. Coburn thought Goldman may have been looking to part ways legally with its employee. (Goldman Sachs has said Mr. Tourre did nothing improper.)

Deal Journal spoke with a couple of legal experts on Monday, before the hearing, who said it was in Goldman's interest to stick with Mr. Tourre. First, the investment bank has stated publicly that it stands behind Mr. Tourre and it would be awkward to reverse course. Second, Goldman may need Mr. Tourre as much as he needs Goldman. Left to defend himself, Mr. Tourre could turn on his former firm and, potentially, disclose embarrassing information about it, the lawyers said.

And of course, Mr. Coburn could simply have been trying to portray Goldman as heartless and unseemly in an effort to discredit the investment bank's claims of having high ethical standards. Indeed, later in the hearing Mr. Coburn asked Goldman finance chief David Viniar whether he thought it was "unethical" to release Mr. Tourre's emails. Mr. Viniar said he thought there was nothing unethical about it, but that he wasn't involved in the decision to release them.

Mr. Coburn later asked CEO Lloyd Blankfein about the email release. Mr. Blankfein also said he wasn't directly involved in releasing the emails. Mr. Coburn pressed both executives, asking why Goldman didn't release emails from other employees. Neither seemed to have a ready answer.

In a voicemail to Goldman employees shortly after the SEC charges were released, Mr. Blankfein distilled the case to its essentials: "The core of the SEC's case is the allegation that one employee misled two professional investors by failing to disclose the role of another market participant in a transaction."

Regardless, Mr. Coburn's questioning seemed only to make Mr. Tourre more sympathetic in the court of public opinion.

As one commentator on the Deal Journal Web site wrote about the Tuesday hearings: "Free Fab."

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Goldman Shows How It Can Still Lobby Hard

Despite Being Under Fire, the Wall Street Firm Pulls Out the Stops to Protect Its Derivatives-Trading Operation

By Elizabeth Williamson and Brody Mullins

WASHINGTON—Goldman Sachs Group Inc. is lobbying hard to kill a provision in financial-industry overhaul legislation requiring big banks to sell off their derivatives-trading businesses, and rival banks are welcoming the help, shrugging off attacks on the firm by lawmakers and securities regulators.

Goldman’s lobbying could put Democrats and the White House, which is lukewarm on the provision, in a difficult position. With congressional elections looming in November, lawmakers don’t want to appear supportive of Goldman or Wall Street.

But Goldman’s leadership is less concerned about politics than the provision itself, known as “section 106.” The nation’s five largest banks together earned $233 billion from derivatives trading in 2009, and are working separately and together to defeat the provision.

“I don’t think political Kabuki theatre is having any impact on the ability to get meetings and be heard” in Congress, says a person familiar with Goldman’s strategy. “The point of the matter from their standpoint is they can be heard. Nobody’s being treated like lepers.”

Late Wednesday some lawmakers predicted section 106 wouldn’t be included in the final legislation, although the outcome isn’t certain. The Senate is expected to begin debate on the bill to overhaul regulation of financial derivatives Thursday.

The White House has been lukewarm on the section-106 provision. A source familiar with the White House’s deliberations said the president pulled back other administration officials who wanted to work to drop it.

Goldman is focusing its efforts on congressional delegations from New York and New Jersey, whose region could lose significant tax revenue should the derivatives provision pass.

Key to bankers’ effort to defeat the provision, three people involved say, is lobbying by the U.S. Chamber of Commerce, the Securities Industry and Financial Markets Association, the Business Roundtable, and Financial Services Forum.

Goldman and other big banks have gotten the ear of New York Democratic Sen. Kirsten Gillibrand, who says she has “concerns” about a central provision in the legislation.

Wednesday, after a weekly luncheon for Senate Democrats, Ms. Gillibrand spoke with Agriculture Committee chairwoman Blanche Lincoln (D., Ark.) to argue against the provision, which Ms. Lincoln authored.

“The senator reiterated her support for the bill, which she voted for, but also shared these concerns,” said Matt Canter, Mrs. Gillibrand’s spokesman.

“Our office has been hearing from many New York companies and consumer organizations about this legislation,” a spokesman for Ms. Gillibrand said Wednesday. “Senator Gillibrand does share the president’s concerns about whether this one provision could impact lending to small businesses.”

Ms. Gillibrand, also fighting for her seat in November, is attending a fund-raising event on Monday with many longtime Democratic backers who also work on Wall Street. An invitation to the event offers “a political discussion” with Sen. Chris Dodd (D., Conn.) and Ms. Gillibrand at a private Park Avenue residence Monday. Donors are encouraged to contribute and solicit up to $19,800 to achieve “host” status. The person familiar with Goldman’s strategy said the firm wouldn’t rule out sending a representative to the event.

Goldman Sachs has ramped up its Washington lobbying operation in recent years and now ranks among the top corporate spenders on lobbyists. Last year,
the company spent at least $2.8 million to influence Congress and the Obama administration.

That is more than double the $1.2 million Goldman spent on lobbying four years ago, according to records compiled by the nonpartisan Center for Responsive Politics.

Goldman's Washington operations are run by Michael Paese, a former aide to House Financial Services Committee Chairman Barney Frank (D., Mass.). Mr. Paese oversees a team that includes 14 outside lobbying firms encompassing. In the last few years, Goldman has beefed up its ranks of Democratic lobbyists, including former Rep. Richard Gephardt, a Missouri Democrat who once was one of the top Democrats in the U.S. House.

The firm also employs a number of senior Republican lobbyists, including Ken Duberstein, a former White House chief staff for President Ronald Reagan.

Goldman also is big source of campaign donations for both Democrats and Republicans. Since 1989, Goldman's political-action committee and employees have been the No. 1 corporate source of campaign donations to the Democratic Party with a total of $20.3 million, according to the Center for Responsive Politics. President Obama received about $1 million from Goldman employees for his 2008 presidential campaign.

The company and employees also are the fourth-largest source of political donations to Republicans with $11 million.

The SEC's lawsuit has damaged some of the relationships Goldman has nurtured, including with Ms. Lincoln, chief mover behind derivatives provision.

Ms. Lincoln, facing a stiff reelection primary campaign, proposed the derivatives legislation on April 9, the same day that the SEC announced its lawsuits against Goldman.

A few weeks ago, Mrs. Lincoln was in discussions with Goldman about hosting a fund-raiser in New York with employees. She has since said she would no longer ask for campaign donations from Goldman or its employees.