Senate Readies Goldman Assault

Assails Bank’s Shorting Strategy as Blankfein, Other Executives Set to Testify

GOLDMAN SACHS GROUP Inc. had a clear strategy of shorting the collapsing mortgage market and made $3.7 billion through the tactic, Senate investigators said, setting up a showdown with Goldman executives testifying before a Senate subcommittee Tuesday.

The testimony was poised to highlight the fundamental split between lawmakers who see Goldman as an archetype of the problems that drove the financial system into crisis and the Wall Street firm, which says it was merely managing risk and didn’t make big profits from housing’s decline.

Goldman Chairman and Chief Executive Lloyd Blankfein was set to tell the Permanent Subcommittee on Investigations that Goldman acted “as our shareholders and our regulators would expect.”

In prepared testimony, Mr. Blankfein said: “We didn’t have a massive short against the housing market and we certainly did not bet against our clients.”

In a briefing Monday, the subcommittee’s chairman, Sen. Carl Levin (D., Mich.) made the opposite case. The subcommittee said Goldman’s strategy of “shorting” the mortgage market—betting on its decline—was so extensive that, at one point in mid-2007, its mortgage business made up more than half its value at risk, a measure of the firm’s overall exposure.

“By early 2007 the company blew right past a neutral position,” the email says. “The damage this has done to our franchise is very significant. Aggregate loss of our clients on just these 5 trades alone (sic) is 1bn.”

“[B]oy, that timerewolf[1] was one s— deal,” Thomas Montag, who helped run Goldman’s securities business at the time, wrote in June 2007, according to documents released by the subcommittee. A person familiar with the deal said it was completed months before the email.

In early 2007, Mr. Blankfein referred dismissively to Goldman products being readied for sale. “[Y]ou refer to losses stemming from residual positions in old deals,” he wrote in an email. “Could/should we have cleaned up these books before and are we doing enough right now to sell off cats and dogs in other books throughout the division.”

A transaction created by Goldman, called Timberwolf, was a $1 billion package of complex securities rated Triple A. The head of Goldman’s mortgage department, Daniel Sparks, sent a mass email promising the sales force “gnormous credits” for selling it, according to documents released by the panel.

The collateralized debt obligation was cut to junk status in just over a year. Among the deal’s buyers was Bear Stearns Asset Management, the money-management unit of Bear Stearns.

The unit had about $300 million in the security, which was rocked by the 2007 collapse of two in-house hedge funds.

“I recognize, however, that many Americans are skeptical about the contribution of investment banking to our economy and understandably angry about how Wall Street contributed to the financial crisis,” the testimony said. “What we and other banks, rating agencies and regulators failed to do was sound the alarm that there was too much lending and too much leverage in the system—that credit had become too cheap.”

Mr. Blankfein said Goldman lost $1.3 billion from its activities in the residential housing market in 2007 and 2008.

The subcommittee also released excerpts from a raft of internal Goldman emails and other materials providing further insight into what some Goldman executives called a “big short” strategy. “I concluded that we should not only get flat, but get VERY short,” executive Joshua Birnbaum wrote in reviewing his own performance in 2007. “Much of the plan began working by February ...and our very profitable year was underway.”

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Goldman executive Michael Sweson, described 2007 as the year “that I am most proud to date” because of his efforts to steer the firm off the subprime rocks through “efficient shorts.”

Another message from an unnamed executive says that some of Goldman’s shorting left hard feelings among clients in October 2007. “Real bad feeling across European sales about some of the trades we did with clients,” the email says. “The damage this has done to our franchise is very significant. Aggregate loss of our clients on just these 5 trades along (sic) is 1bn.”

Mr. Blankfein was set to say that April 16, the day of the SEC suit, was “one of the worst days in my professional life.” While reiterating that Goldman doesn’t think it did anything wrong in the case, he offered a more contrite note in his testimony.

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Tourre: A Hero in Villain’s Garb?

Goldman Sachs's Fabrice "Fabulous Fab" Tourre isn’t a villain. There is reason to find him an unwitting hero of the public conscience, despite whatever efforts are made by a camera-hungry row of senators on Tuesday.

Just read a series of 2007 personal emails from the Goldman mortgage banker, recently released by the bank. Endearingly smitten by his girlfriend, the then-27-year-old shares with her questions about his place in an ever-abysmal realm of CDS, CDOs, and CDO-squareds.

Senators will delight in these sarcastic emails, grilling the only person charged in the SEC’s blockbuster fraud case against the bank. While Goldman says its employee has done nothing wrong, even a firm spokesman calls the emails “immature and embarrassing to the firm.”

Mr. Tourre still raises the uncomfortable question faced by Wall Street in this mounting regulatory debate: The need to convince a skeptical public that its work has social value. In hundreds of pages of documents from across the firm, only the young, overworked vice president struggles with the ethical role of high finance in a broader society.

Mr. Tourre comes to view his job constructing highly structured mortgage products as a farce.

“[T]he real purpose of my job is to make capital markets more efficient and ultimately provide the US consumer with more efficient ways to leverage and finance himself, so there is a humble, noble and ethical reason for my job,” he writes to his girlfriend Marine Serres in January 2007.

At Goldman’s top levels, there is little of Mr. Tourre’s introspection. Instead, the firm proudly touts “conflict management” with clients—the thorough, technical handling of competing interests inside and outside the firm.

Such conflicts have grown over the past decade, as Goldman has moved deeper into trading, while keeping its own hand as investor and adviser. There are now at least 10 committees and processes for reviewing those conflicts, according to previous Goldman statements in Senate hearings. Inside Goldman, this is taken as a sign of comfort, not alarm, say executives at the firm.

In emails swapped between Goldman’s top bosses, one sees the idealism of Mr. Tourre yielding to the brutal, necessary work of running a bank. By contrast, Lloyd Blankfein, Gary Cohn, and other Goldman brass don’t pause to consider the effects of selling mortgage packages designed to fail—the issue at the heart of the SEC lawsuit and Senate hearing. The emails show them focused, as they should be, on protecting the bank from a coming financial crisis.

It still isn’t enough for the people in the trenches, at least according to Mr. Tourre. He expresses deep doubts about some of the very things that got Wall Street in such a mess.

“Well, what if we created a ‘thing’, which had no purpose, which is absolutely conceptual and highly theoretical and nobody knows how to price?” he writes to a friend in January 2007.

Mr. Tourre’s words and attitude may well be used against him. But they show a basic insight that seemed to have been garbled at Goldman’s highest levels, ever confident in its array of conflict-management plans.

“Once you’ve been in the water long enough you no longer perceive you’re in water. Water is the norm,” says Adam Galinsky, a Northwestern University business-school professor who conducts studies on power and influence inside companies.

“This is why newcomers are important,” said Professor Galinsky. “They can see the good and bad of a culture for the first time.”

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