

1 name individual? No settlement." Right.

2 And then I want to show you another document which
3 we're going to mark as Exhibit 24 which is an e-mail exchange
4 that starts with an e-mail from you to Lorin Reisner,
5 1/24/2010, 11:16 a.m.

6 (Exhibit No. 24 was marked for
7 identification.)

8 THE WITNESS: Okay.

9 BY MR. KOTZ:

10 Q And in that e-mail, in the e-mail exchange in
11 Exhibit 24, you state in the e-mail to Lorin Reisner on
12 1/24/2010, 11:16 a.m., "Mary mentioned today that it is the
13 case she is most focused on. No surprise," referring to
14 ABACUS.

15 What do you recall about the Chairman's particular
16 interest in moving this case forward?

17 A Well, I just want to be -- I don't know what
18 particularly she had in her mind about what she was focused
19 on.

20 Q Sure.

21 A But from my conversations, at least in January, my
22 recollection is that she was very disappointed after the
23 December New York Times articles. We had a handful of
24 conversations between that -- there was the McClatchy
25 articles, then there was the New York Times.

1 She probably -- I may have apprised her that it was
2 going to be calendared in December and moved to January. And
3 then -- so she was -- at this point, and I'm asking, when are
4 we bringing it? Because now the whole story about the ABACUS
5 CDO was public, and she was anxious for us to bring a case,
6 if we had one, so that our actions were part of the public
7 discourse on it.

8 Q All right. Then let me show you the next document,
9 which is Exhibit 25, an e-mail at the top from (b)(7)(C)
10 to you, with a copy to (b)(7)(C) 1/27/2010, 1:12 p.m.

11 (Exhibit No. 25 was marked for
12 identification.)

13 BY MR. KOTZ:

14 Q And this one has an e-mail from you to (b)(7)(C)
15 (b)(7)(C) Wednesday, January 27, 2010, 12:04 p.m. "Please
16 pull the ABACUS from the calendar at the request of the
17 Enforcement Division. It will be rescheduled shortly."

18 A Uh-huh.

19 Q So the case is moving forward. There's discussions
20 of finalizing the complaint, talking about the different days
21 that the case is going to be filed, assuming the Commission
22 approved it.

23 The Chairman says that she's anxious to get the
24 case out and that it's the case she's most focused on. But
25 it's pulled. How come?

1 A The Chairman is one of five Commissioners. My
2 recollection is that there was a lot of discussion on Tuesday
3 and witness, January 26th and 27th, between and among
4 Commissioners, Commissioners' counsel, enforcement staff, and
5 as is often the case, among Commission counsel, about the
6 ABACUS case.

7 I think each office had some questions, issues, or
8 concerns that they were grappling with. And I think there
9 developed a consensus by Wednesday morning, the 27th, that
10 the Commission would benefit in putting this off until a
11 later time.

12 I think the specific concern -- there were legal
13 questions that some Commissioners had, which is normal
14 discussion and debate. I think, to my recollection, what
15 pushed it to -- pushed us to agree to take it off the
16 calendar was a view that there was a lot of questions about
17 Eagle and whether there were going to be any other
18 individuals.

19 I think there was -- there might have been another
20 individual that --

21 Q Paulson?

22 A Sorry?

23 Q Paulson?

24 A No. I'm not thinking so much about Paulson. I
25 could be wrong, but I thought there was another person.

1 There might be another person, either at Goldman or maybe
2 at -- not Paulson himself, but at the Paulson firm. There
3 was someone else that was at least in the mix that they were
4 thinking about.

5 I think that might have been reflected in the memo,
6 or it might have been disclosed to the counsel in the
7 meetings. And a number of Commissioners believed, given that
8 this was going to be a case receiving a lot of public
9 scrutiny, we should go forward with our full or best foot,
10 that if we're not sure if we're going to -- I think there was
11 some discussion about whether to Wells Eagle.

12 Q Right.

13 A And I think the conclusion -- ultimately perhaps
14 unanimous; if not, a majority view -- was we should really
15 wait until we have the full case that we may bring. It's not
16 unusual for us to bring a case, to continue to investigate,
17 and to bring more people into an action later.

18 So their concern wasn't that it's not appropriate.
19 It was more that in this particular case, folks felt like the
20 case would benefit from bringing additional parties if they
21 were available.

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And in my discussions with the Chairman and among other Commissioners' offices, there seemed to be a consensus it would benefit by putting this off.

Q Okay. I mean, the Chairman testified that she had a conversation with Commissioner Casey where Commissioner Casey expressed the view that we shouldn't bring it piecemeal, we should bring it all together.

Is that consistent with your recollection?

A The Chairman shared that conversation with me.

Q Yes.

A It's consistent. I had those conversations with counsel to Commissioner Casey, I actually think counsel to Commissioner Paredes, counsel to Commissioner Walter, and maybe even Commissioner Aguilar, I believe that that issue came up with all of the Commissioners' offices.

Q So in a sense, the decision was made -- although it was pulled at the request of the Enforcement Division, it was made in the January time frame to remove the ABACUS case from the calendar because of some feedback from the Commissioners from and their counsels.

A That's correct.

Q And essentially, the idea was, let's determine everything we can, investigate thoroughly all aspects of the

1 case, determine if there are any other individuals who may be
2 charged, and once all those determinations are made, then
3 bring it.

4 Is that fair?

5 A Correct. Yes. I don't think it was that -- if we
6 brought it on the on the 28th, I don't think the decision was
7 the Commission -- a majority of the Commission might not
8 approve it. I think there was a consensus that it would be
9 better, on balance, to wait and have the whole thing and
10 consider it then. That was the consensus, if not unanimous,
11 view.

12 Q Okay. And there was another matter that was raised
13 by Lorin Reisner, an issue he was looking at, to reach out to
14 certain entities to get more information in Germany.

15 Do you remember that issue as well? That was sort
16 of -- seemed to be an enforcement-based issue at that time.

17 A It was. But my recollection of conversations with
18 Lorin and perhaps Reid was that it was also discussed at some
19 level with the Commissioners. I don't think it was the
20 driving factor. But for enforcement, it made it even easier
21 to pull it because I think Lorin and Rob, in particular,
22 thought they would feel more comfortable.

23 IKB was the principal victim, if you will, investor
24 in the ABACUS deal. They lost \$150 million. And they were
25 in Germany. And there was evidence in the record that

1 related to -- they had told the Enforcement staff a variety
2 of things about the transaction.

3 But I think Lorin and Rob would have preferred more
4 solid evidence that would give them comfort in litigation.
5 They could go to Germany and take a deposition. So Lorin was
6 looking for like a declaration or something from a particular
7 witness at IKB. It would give him more comfort going into
8 this whole thing.

9 So I think they sort of thought -- well, I don't
10 know if it was a rationale or whatever -- but, by the way, it
11 wouldn't hurt if we had more time to go to Germany and shore
12 up this witness while we're at it. And I think that gave
13 everybody comfort that this was a good decision all around.

14 Q But you don't know that was the driving force? You
15 think the driving force was, generally, feedback from the
16 Commissioners?

17 A Yes.

18 Q All right. Let's go to the next one. We're going
19 to mark the next one as Exhibit 26, an e-mail exchange, with
20 the top e-mail from Tim Henseler to (b)(7)(C) with a
21 copy to Eric Spitler, (b)(7)(C) and you, 2/22/2010 at
22 2:50 p.m.

23 (Exhibit No. 26 was marked for
24 identification.)

25 THE WITNESS: Okay.

1 BY MR. KOTZ:

2 Q Do you remember this issue, where the PSI was
3 seeking to have Rick Bookstaber testify at a hearing?

4 A I do.

5 Q What do you recall about that?

6 A My recollection was that --

7 Q This is, I guess, initially they wanted just to
8 talk to him.

9 A Yes. I don't remember it being an issue of him
10 testifying initially, but that they wanted him to consult, I
11 guess, with them on a somewhat ongoing basis because Rick is
12 an extraordinarily smart person who's extremely knowledgeable
13 in this space. He's widely know.

14 Q Right.

15 A So I think they thought they might be able to learn
16 from Rick, or be able to bounce some things off of him to
17 make sure they were on the right path, kind of like a
18 compass, if you will, substantive compass.

19 Q Right.

20 A And I recall having conversations with Tim and Eric
21 and others about that and whether -- because we had an
22 ongoing investigation and it raised questions about whether
23 that would be appropriate or not.

24 Q And what was the determination made about whether
25 Rick Bookstaber should act in this role that PSI was seeking?

1 A I'm not sure I know the final outcome. The last I
2 recall hearing was that there was reluctance because of a
3 concern that we might want to talk to him here. But I don't
4 actually know how it was resolved.

5 Q But Rick Bookstaber wasn't working on the Goldman
6 investigation for the SEC. Right?

7 A Correct.

8 Q So there was no coordination or effort to have Rick
9 Bookstaber coordinate matters between the SEC vis--vis the
10 Goldman investigation and the PSI?

11 A Absolutely not. On the contrary, the only reason
12 this was being entertained at all, and we had specific
13 discussions about this, was because Rick didn't know anything
14 about our investigation. If he had knowledge of our
15 investigation, I'm quite sure we wouldn't have even been
16 having that debate.

17 Q And you don't even know if Rick Bookstaber actually
18 was engaged in this role at the end?

19 A I don't know. But I do know that as of this
20 e-mail, that my recollection from conversations is that
21 Enforcement had not consulted with Rick at all about the
22 investigation.

23 Q The Goldman investigation?

24 A The Goldman investigation. Correct.

25 Q All right. Let's move to the next one. We're

1 A Absolutely not.

2 Q And did she ever indicate anything at all, in any
3 of the meetings in which she participated where Goldman's
4 investigation was raised, that there was a financial
5 regulatory reform bill out there, and that it would help
6 financial regulatory reform if the SEC got a big case like
7 Goldman out?

8 A Never.

9 Q Do you recall any conversations in any meetings
10 that the Chairman participated in where she was briefed on
11 Goldman that related to issues other than the facts and law
12 of the Goldman case?

13 A No.

14 Q All right. Let's move on to the next document.
15 Exhibit 31 starts off with an e-mail from (b)(7)(C) to
16 you, copy to (b)(7)(C) Wednesday, March 24, 2010,
17 11:18 a.m.

18 (Exhibit No. 31 was marked for
19 identification.)

20 THE WITNESS: Okay.

21 BY MR. KOTZ:

22 Q And so you say in the second e-mail down on this
23 page, on Wednesday, March 24, 2010, 11:16 a.m. to (b)(7)(C)
24 (b)(7)(C) "Please hold a spot for this on 4/14 between us,
25 but keep the pressure on for the memo."

1 A During the week of this week, when we started
2 talking about bringing the Goldman case, on one hand the view
3 was that this was a significant case arising out of the
4 credit crisis, particularly related to mortgage-backed
5 securities, which is an area that the public was very
6 interested in; and that, therefore, it would counsel in favor
7 of a press conference to get a wider audience.

8 A press conference basically means more likely to
9 be on TV, and TV actually is more likely to reach the most
10 number of people. Therefore, press conferences are more
11 likely to get a message out about all of our
12 enforcement-related messages out to the widest audience.

13 On the other hand, there were some people who
14 believed that the public might view this as -- this might
15 seem interesting in hindsight -- but not that big of a deal.
16 So the first big CDO-related case you bring from a firm like
17 Goldman, you know, the big investment bank, is over a case
18 that they made \$15 million. And so people would say, that's
19 really the best the SEC has to offer?

20 So that was a constant debate from about this time,
21 quite frankly, up until Wednesday, I think, even.

22 Q But the determination was made to do a press
23 conference?

24 A Correct.

25 Q Because the prevailing view was it would be viewed

1 positively?

2 A Yes. It was worth -- it was important enough that
3 the benefits seemed to outweigh the potential concerns.

4 Q And even among the folks who believed that there
5 would be positive attention on the SEC arising out of the
6 Goldman case, is it fair to say that folks were surprised at
7 how much positive attention and how much attention in general
8 the Goldman case?

9 A Yes. That is very fair to say.

10 Q And is that something that you felt personally that
11 you were surprised?

12 A Yes.

13 Q All right. Let's move on to that week. So the
14 next document we're going to mark is Exhibit 34. This starts
15 with an e-mail exchange from Robert Khuzami to Mary Schapiro
16 with a copy to you, 4/12/2010, 10:54 p.m.

17 (Exhibit No. 34 was marked for
18 identification.)

19 MR. KOTZ: And then I will show you the next one
20 also so you have the context.

21 THE WITNESS: Okay.

22 MR. KOTZ: So the next document, just so you have
23 context, that we're going to mark as Exhibit 35, is an e-mail
24 from you to Mary Schapiro. And although it didn't print out,
25 we can tell you that it was Wednesday, 4/13/2010,

1 Q Right.

2 A I'm sorry. I was trying to get --

3 Q So the first e-mail --

4 A These are in order.

5 Q Yes. The second one is actually only a few hours,
6 even though it turned to a different day. It was only
7 actually a couple hours after the first one.

8 But it looks from this e-mail that the approach at
9 that point was to file Quadrangle on Wednesday and Goldman on
10 Thursday.

11 A That's my recollection.

12 Q Okay. And Mary Schapiro specifically said, "Let's
13 make sure we don't announce Goldman same day."

14 Do you know what her thinking was there?

15 A Yes. She had two reasons, I believe. There's the
16 general view and the specific view.

17 Her general view, and we all share this, is
18 bringing two very large cases the same day isn't a very good
19 idea because it'll -- the press will be -- they'll be
20 confused, first of all: Which one do we focus on? But
21 again, our goal is always to get our enforcement message out
22 widely, and we would lose that if we brought two cases the
23 same day.

24 I think her other concern was that Cuomo would take
25 it that we brought Goldman on the same day, even though it

1 wouldn't be true, to beat out his Quadrangle case. And she
2 didn't think that that was a terribly good idea.

3 Q So **Cuomo** might be upset that Goldman was filed on
4 the same day as Quadrangle, and perhaps if it got more
5 immediate attention, then he would be upset that the SEC did
6 that?

7 A In my experience, working with his office -- I
8 don't know him personally -- and in interactions I've had,
9 been part of, with him, he would take it as a personal
10 affront to his action -- he would take it that we did it on
11 purpose, even if we didn't, and would be offended and angry.

12 Q Now, what about the idea of filing Goldman on
13 Wednesday and Quadrangle on Thursday? I mean, why did you
14 choose going with Quadrangle first?

15 A We didn't have any control over that. On this
16 particular matter, **Cuomo**'s office was driving the timing, as
17 the case on multiple occasions related to this and other
18 investigations.

19 My recollection is we got very little notice that
20 they were ready to bring this case. They said, we're
21 bringing this case. And oftentimes we have a late stage
22 investigation and we're ready to go also, but we're rushing
23 to kind of close the loop so that we can bring our case with
24 theirs at the same time.

25 Q So you had two big cases that week, Goldman and

1 Quadrangle. You didn't have a choice as to when to bring
2 Quadrangle. So the only one that you could potentially have
3 any discretion on was Goldman?

4 A Correct.

5 (b)(7)(C) Could you have brought Goldman on
6 Wednesday?

7 THE WITNESS: Well, the meeting was Wednesday. So
8 in theory, we could have brought it on Wednesday and there
9 was -- but the problem was, my recollection is that they
10 weren't ready.

11 I don't think the staff was ready to -- believe it
12 or not, even though the discussion in January about the
13 complaint not being ready, this week it was the same
14 circumstance, that my recollection is that Lorin in
15 particular, Lorin Reisner, was working on the complaint
16 until -- I think until the morning that it was brought.

17 MR. KOTZ: All right. Well, let's go through the
18 e-mails. So the next one we're going to mark as Exhibit 36.
19 And that starts with an e-mail from Reid Muoio to Ken Lench
20 and (b)(7)(C) 4/14/2010, 11:06 p.m.

21 (Exhibit No. 36 was marked for
22 identification.)

23 MR. KOTZ: And then I'm going to give you --
24 together with that I'm going to give you Exhibit 37. I'm not
25 sure you're on these e-mails, but they're still e-mails that

1 And Reid Muoio says, "Front office. Just don't know their
2 thinking."

3 So what I'm trying to understand is what changed
4 such that as of Tuesday morning, it was -- Goldman was going
5 to be filed on Thursday, and then on Wednesday, the decision
6 was made to file Goldman on Friday.

7 A Cuomo moved the Quadrangle case to Thursday. So
8 once the Quadrangle case got moved to Thursday, we agreed to
9 move -- we just pushed it back a day and agreed to do Goldman
10 on Friday.

11 Q And as your counsel indicated, was there any
12 discussion about pushing Goldman forward on Wednesday? Or is
13 that the point in which you felt that the complaint wasn't
14 ready?

15 A I don't believe that folks thought that they were
16 ready. I don't remember any serious discussion about doing
17 it Wednesday because I think people came quickly to the fact
18 that we weren't ready by Wednesday.

19 I think the other -- I think the other issue, quite
20 frankly, is that the expectation was going to be that
21 Wednesday afternoon's meeting was going to be quite long. So
22 I don't know when -- and in fact, my recollection is that it
23 went until after 5:00. So I don't know when on Wednesday we
24 would have done that.

25 Q And --

1 was made based on the fact that Quadrangle was moved and the
2 Chairman herself said, we don't want to bring both of them on
3 the same day?

4 A I think -- and just on the point, the Chairman
5 didn't want to bring them both the same day. But that's --
6 nor would Rob have wanted to bring them both the same day.

7 Q It wasn't unique to --

8 A Just so there's no lack of clarity.

9 Q It wasn't unique to her. That would definitely
10 have been Rob's and Lorin's views. And I don't think anybody
11 would want to bring -- it's much our general practice not to
12 bring, if possible, two big cases the same day.

13 So it wasn't that they were doing it because the
14 Chairman directed it so much as a consensus view. But I
15 think, to your specific question, I think it was a consensus
16 view. But from their perspective, I don't know that they had
17 visibility into the discussions around Quadrangle. So all
18 they know is that their bosses told them that we were doing
19 it on Friday.

20 Q But you're clear in your recollection that the
21 reason that the Goldman case was moved from being filed on
22 Thursday to Friday was Quadrangle was moved?

23 A As far as I'm concerned, I'm crystal clear that
24 that was the reason.

25 Q All right. I'm going to go to this one.

1 Did you ever get an answer to that?

2 A Not to my knowledge.

3 Q All right. Let me show you the next document we're
4 going to mark as Exhibit 39. It starts off with an e-mail
5 from Myron Marlin to you -- to John Nestor with a copy to you
6 and (b)(7)(C) Thursday, April 15, 2010, 12:38 p.m.

7 (Exhibit No. 39 was marked for
8 identification.)

9 THE WITNESS: Okay.

10 BY MR. KOTZ:

11 Q Now, Myron Marlin, I guess, in his communications
12 role was preparing a timeline of events for Thursday and
13 Friday?

14 A Yes. He does this from time to time.

15 Q And there's references now to the Stanford report,
16 which I guess is the Office of the Inspector General report?

17 A Yes.

18 Q Did you ever hear any conversations where it was
19 discussed -- where the Stanford OIG report was discussed in
20 relation to when the Goldman case would be filed? In other
21 words, when somebody said, we want to file the Goldman case
22 on X time because of the Stanford IG report?

23 A No.

24 Q Do you have any idea why the Goldman case was filed
25 first thing, and then the Stanford report second?

1 for reporters to, you know, start calling us around Thursday
2 or Friday, after closed meetings, about matters from time to
3 time.

4 And we were concerned that the story was going to
5 get out before we were able to put it out in the way in which
6 we believe it's appropriate to put it out. And obviously, it
7 raised a concern with us about how it was that the reporter
8 would get this information.

9 Q Do you know which reporter it was?

10 A I never talked to Scott, so I don't know. But I do
11 recall having conversations around this time that Kara
12 Scannel from the Wall Street Journal might have been calling
13 around. But I don't know if there was Thursday. I don't
14 know if that's who Scott was talking about.

15 Q Did you ever learn who might have provided this
16 reporter with that information?

17 A No. I don't know that -- knowing that it's on the
18 calendar is one thing, as opposed to knowing -- that's a
19 discrete piece of information --

20 Q Right.

21 A -- that a very large number of people would have
22 had access to, as opposed to the decision, perhaps, or more
23 detail about the meeting.

24 Q But nevertheless, the fact that a matter is on the
25 calendar is nonpublic?

1 this article had the vote, did it?

2 Q No.

3 A My recollection is that Kayla was not in the office
4 on this day, and so -- I don't know where she was. I just
5 thought it would be better to talk. It's my general
6 preference.

7 Q All right. I'll show you the next document, marked
8 Exhibit 42. It starts with an e-mail from you to Myron
9 Marlin, 4/18/2010, 3:38 p.m.

10 (Exhibit No. 42 was marked for
11 identification.)

12 THE WITNESS: Okay.

13 BY MR. KOTZ:

14 Q First of all, you were aware that the actual vote
15 that was clearly nonpublic information from the Commission
16 meeting about the Goldman lawsuit was leaked to the press?

17 A Correct.

18 Q And are you aware of who might have leaked that to
19 the press?

20 A No.

21 Q Now, in this e-mail, Ken Lench is saying that in
22 addition to hearing it was a 3-2 vote, that one of the
23 Republicans was unhappy because Goldman was not given the
24 chance to settle. And this is also subject: Kara Scannel.

25 A Right.

1 Q And you say, "I do not believe that is true."

2 What were you referring to as not true?

3 A I didn't believe it was accurate that Goldman -- I
4 didn't think it would be accurate for a reporter to write
5 that Goldman wasn't given a chance to settle.

6 Q Do you know if it's accurate to say that one of the
7 Republicans was unhappy because maybe they thought Goldman
8 was not given a chance to settle?

9 A That's not what I was referring to. But I don't --
10 I don't -- candidly, I don't recall that being one of the
11 issues that any Commissioner raised. But I presume I was
12 addressing the substance of the point as opposed to the
13 procedure.

14 Q All right. And so getting to the substance of the
15 point, I wanted to ask you about that.

16 Was it your understanding -- I mean, you had
17 experience in enforcement even before you came into the
18 Commission's office. Was it your understanding that it was
19 sort of the general policy or protocol of the Enforcement
20 Division, traditionally, that when they were going to bring
21 an action, after the Commission approved the recommendation
22 to go forward with the action, a call would be made to the
23 defendant saying, the Commission's approved it; you know, you
24 got one last chance to try to resolve this, you know,
25 48 hours or whatever?

1 A I think I would call it a common practice. It's
2 certainly not a rule, and I've certainly been part of other
3 cases, not including this one, where we didn't do that. So
4 it's not uncommon to not offer that call, particularly -- and
5 now I'm not necessarily talking about Goldman, but I think it
6 applies, where there's an impression among the staff that
7 settlement is not likely.

8 Q So is it your understanding, then, in the
9 particular case on Goldman, the decision was made
10 affirmatively not to follow that practice of, immediately
11 after Goldman Sachs -- the case against Goldman Sachs was
12 approved by the Commission, to go back to them, for good or
13 bad reasons; but just initially, the question is, was it an
14 affirmative decision not to call Goldman after the Commission
15 approved the recommendation to go forward with the lawsuit to
16 give them this window?

17 A I don't -- I don't know that I can agree with the
18 proposition that it was an affirmative decision not to call
19 them. I think that the consensus was that there wasn't going
20 to be a settlement, and that nobody called them.

21 But I wasn't part of any discussion where anybody
22 said, and by the way, we won't call Goldman. I think, in all
23 the conversations I had, it was -- it was generally presumed
24 that this was a case that was going to litigate; that
25 Goldman -- I was part of a number of conversations where it

1 was presumed that Goldman had no interest in settling and
2 that it was going to litigate. So nobody was talking about
3 engaging in that kind of conversation.

4 Q Now, in your position, both having worked in the
5 Enforcement Division and the Chairman's office, do you think
6 it is a good practice for the Enforcement Division to really,
7 no matter whether there was indications about settlement or
8 not, to go to a defendant and say, look. We may not have had
9 settlement discussions, but we're bringing the case. The
10 Commission's approved it. You got one last chance?

11 A My honest, personal opinion in this?

12 Q Yes.

13 A I actually don't think it's a good idea to have a
14 practice that parties get an opportunity to settle after the
15 Commission approves an action because I think that undermines
16 the Enforcement Division's ability to have honest discussions
17 about possible settlement in many instances beforehand.

18 If companies know that every time they get a --
19 it's like a second bite at the apple. If they know that they
20 get to first see if the Commission approves the action and
21 then they get a chance to settle, my personal opinion is that
22 doesn't send a particularly good message because it
23 undermines the ability of the Enforcement staff to have any
24 impetus to settle, you know, in many instances.

25 So I think there are instances where -- I think

1 it's a discretionary issue. If the staff believes that it
2 would be fruitful to engage in settlement discussions, I
3 think it's a very good idea because it's always -- it's
4 better to settle and not use the litigation resources if you
5 can come to a good settlement.

6 But as a general policy matter, to have a rule that
7 you always call a company after and see if they want to
8 settle, my personal view is that that would be a bad policy.

9 Q Okay. Now, do you think that because it was common
10 practice for the SEC to do that, and that perhaps lawyers who
11 represented a lot of clients in SEC cases or companies who've
12 been familiar with SEC cases knew that it was common practice
13 for the SEC to contact the defendant after the Commission had
14 recommended going forward with the action, that in this case
15 Goldman might have been waiting for that call; and that if
16 that call had been made, they might have had settlement
17 discussions before the case was filed?

18 A I'm certainly aware that the conversational wisdom
19 among securities defense lawyers is that that's the practice
20 by the staff. I wouldn't comment on what Goldman was
21 expecting other than to say, again, we had a lot of
22 discussions around the interactions between the team and
23 Goldman.

24 And at least my impression was that they made it --
25 they were sort of scorched earth about it in their approach,

1 A I was not aware of that.

2 (b)(7)(C) NYSE Reg. Right?

3 MR. KOTZ: Yes. But I don't know if it was the
4 NYSE Reg or not. Some portion of the NYSE. I'm not sure if
5 it was (b)(7)(C) but somebody in the NYSE.

6 THE WITNESS: It's only relevant because I think
7 they're separate entities.

8 MR. KOTZ: Okay. Yes.

9 THE WITNESS: So it's not necessarily a chain. So
10 I just -- for clarity purposes --

11 BY MR. KOTZ:

12 Q But do you think it's a good practice, where the
13 SEC has a matter that could potentially cause a significant
14 impact on the market, that they give the NYSE, whether
15 Regulation or another part of it, a heads up?

16 (b)(5)
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23 Q Okay. I'm going to show you the next document,
24 speaking of market surveillance. Exhibit 45 starts with an
25 e-mail from you to Ricardo Delfin, David Becker, and Didem

1 Q Was there a concern expressed afterward because of
2 the effect that the case had on the overall stock market as
3 well as Goldman stock?

4 A We had a number of -- we had received a number of
5 questions or concerns about the fact that it was brought
6 during the trading day affected the overall stock market.
7 And people expressed concern about the timing. But, of
8 course, it was brought -- it would have had -- particularly
9 as to the overall stock market, if it was brought immediately
10 before the trading day, also it would have presumably had
11 that effect. So nothing would have changed.

12 Q But were you aware that when it came to the
13 settlement of the Goldman case, it wasn't announced till
14 after the trading day?

15 A Yes.

16 Q And was that a conscious decision?

17 A It was.

18 Q And what was the reason for that?

19 A Because, in particular, given what we had observed
20 with Goldman in April, and quite frankly, the markets were
21 watching Goldman, including the litigation, closely. And, I
22 mean, every time, as far as I could tell, CNBC talked about
23 it, it would affect their stock price.

24 So there was a concern that bringing it after the
25 close of the markets would allow the information to be

1 equally distributed into the marketplace so that nobody would
2 be advantaged by the information.

3 Q But are you aware that while the SEC announced the
4 settlement of the Goldman case after the market hours, prior
5 to the end of market hours they announced that there would be
6 a press conference, and the announcement of a press
7 conference had a ripple effect on the market?

8 A Sorry. Do you mind --

9 Q Basically, there's two steps. In order to get a
10 press conference, you have to tell reporters that there's
11 going to be a press conference.

12 A Uh-huh.

13 Q You have to do that in advance, before you actually
14 release the information. So the SEC sent out the word to the
15 press that there was going to be a press conference coming
16 up. The word that was sent out was prior to the market
17 closing. The actual press conference occurred after the
18 market closed.

19 A Right.

20 Q But because there were rumors and stories about
21 Goldman, people assumed that when the SEC stated they were
22 going to have a press conference, it was about Goldman.

23 A Right.

24 Q And actually, that did cause the stock to be
25 affected.

1 Were you aware of that?

2 A I recall that the press release notice went out to
3 the media shortly before the market closed, and that the
4 Goldman stock price changed after that.

5 Q And so do you think, in hindsight, maybe that was a
6 mistake, and that even the announcement of the press
7 conference should be after the market if you were going to
8 try to deal with that issue of the effect on the stock?

9 A Yes, apparently. I think it was done -- the
10 announcement of the press release was done very close to the
11 end-of-the-market close. My recollection is that people
12 didn't foresee that that would have the effect that it did.

13 Q All right. Let me show you the next document.
14 We're going to mark it as Exhibit 46. It starts with an
15 e-mail from you to (b)(7)(C) 4/23/2010, 9:29 a.m.

16 (Exhibit No. 46 was marked for
17 identification.)

18 THE WITNESS: Okay.

19 BY MR. KOTZ:

20 Q And do you know what this is about?

21 A I do.

22 Q Okay. Could you tell me?

23 A After we brought the Goldman case, there was
24 another Goldman-related case on the calendar related to
25 Goldman Sachs Execution and Clearing, which is their clearing

1 significant things being discussed over which there were
2 disagreements up till shortly before.

3 Q So at what point was it, though, placed on the
4 calendar for the 15th? That must have been before.

5 A It was. It was shortly before, though. This one,
6 I don't remember specifically, but I believe either Monday of
7 that week or -- within a week. No more than a week before.

8 Q And was that unusual, to have such a quick
9 turnaround, to schedule something for only a week in advance,
10 particularly something, you know, as big a deal as this?

11 A I'm hesitating because if I say it's unusual, it
12 might give you a misimpression. It's unusual in the sense
13 the 95 percent of our cases are calendared in this normal
14 course we talked about earlier.

15 Q Right.

16 A It's not unusual in the sense that at least once a
17 week or every other week, we have a matter that we need to
18 calendar with a very short time frame. So it's not unusual.
19 There's a variety of reasons why we do that. And we try to
20 accommodate Enforcement staff.

21 Here there were particular circumstances that
22 caused them to want to file it within a week's time frame,
23 which would be consistent with the kinds of things we would
24 consider in other cases.

25 Q What were those particular circumstances?

1 A In this circumstance, my recollection is that there
2 were two issues. One is the Tuesday after the settlement,
3 Goldman was going to announce its earnings, and had informed
4 the Enforcement staff that they would be disclosing -- that
5 they needed to reserve \$550 million for a potential
6 settlement with the SEC. So essentially, our settlement was
7 going to go public Tuesday.

8 Also, on Monday, there was a -- their answer was
9 due. And so the sense was they needed to bring the -- they
10 would either have to file a settlement no later than Monday,
11 or file something with the court. Somehow they would have to
12 file something on Monday.

13 So I think, as is often the case with litigants,
14 deadlines, whether it's a jury trial, an answer filing, a
15 motion deadline, drives settlement discussions.

16 Q Right. Right. Now, what about the Commissioners
17 and the Chairman? How would they have enough time to analyze
18 and make a decision on the settlement if, you know, it's
19 still not even finalized a day or two before the meeting?

20 A This is a conversation I have with Lorin and Rob.
21

(b)(7)(C)

 and I working on the car are very -- in the
22 case of our conversations with the Commissioners, are always
23 concerned about ensuring that the Commissioners have enough
24 time to think through things. And, quite frankly, they
25 expect it and prefer it.

1 Q And is that what happened?

2 A That's my understanding. I know, in fact, maybe
3 even as of Friday, I don't know when he -- I don't know when
4 they did it, but Lorin and Rob reached out to the
5 Commissioners, each of the offices, to set up meetings, I
6 think, for the following week to come brief them on the
7 Goldman settlement.

8 Q But it was a relatively short time that the
9 Commissioners had to really consider this because, from what
10 we understand, there were still discussions back and forth
11 early that week that the decision -- that the meeting took
12 place.

13 A Right. So what they did was they sent a memo up.
14 Maybe they offered to come orally brief them. They sent a
15 memo up. I think it was Monday morning, but I can't be
16 100 percent sure.

17 And then the idea would be that the remaining
18 few -- so at least they understand the background behind the
19 settlement, the litigation posture, why they believed it was
20 a good settlement, and all the terms they had agreed upon.
21 And if there was any additional things worked out over the
22 course of that week, there would be supplemental memo and
23 oral briefing.

24 So again, it's not -- this case is certainly -- I'm
25 not trying to downplay that it was a significant case. But

1 out?

2 A My recollection is that by 9:30 Wednesday night, we
3 had decided to bring the case Friday -- I mean, on Thursday
4 already, I think.

5 Q Okay. But the case was brought Thursday afternoon,
6 after the Commission meeting occurred, which ran relatively
7 late in the day.

8 A Correct.

9 Q And do you think one of the reasons that the SEC
10 decided to bring it, instead of the same day as the
11 Commission meeting, afterwards, even though it was late in
12 the day, and not wait till the next day, was because of
13 concerns about leaks and/or Goldman framing the story?

14 A Oh, I do. I only hesitated because I don't believe
15 we made at that time after reading the article. But that's
16 what I meant by this. So I was -- this confirmed -- Myron's
17 view was, and I think John Nestor's view was, that if you
18 bring it Wednesday afternoon, you know, then the --

19 Q Thursday afternoon.

20 A I'm sorry, Thursday afternoon -- then our press
21 release and our complaint goes out, and the people get
22 that -- what we view as -- our press release is obviously
23 from our perspective, but a more objective, from our
24 perspective, view of the facts overall.

25 If you wait till Friday and it leaks, then Goldman

1 gets to control the story. And this was communicating to
2 Myron that, look, Goldman's out first, and so they get to
3 bring the story.

4 Q And so this article sort of accentuated the point
5 you were making?

6 A It accentuated the point that he was making. Yes.

7 Q I'm sorry. Yes. It accentuated the point that
8 Myron was making.

9 A Yes. Out of fairness to Myron, I don't want to
10 leave you with a misimpression because he's very careful
11 about this. He has views about public -- the press. He
12 always caveats his -- if Enforcement has a reason to bring a
13 case at a particular time, like the complaint isn't ready or
14 there's any law enforcement interest, I don't want to give
15 you the impression he drives the train.

16 There's always -- there's always an enforcement --
17 it's always Enforcement's decision at the end of the day when
18 to bring a case.

19 Q Right. But in this case, the Commission had
20 already approved it.

21 A Correct.

22 Q So everything was done.

23 A Well, at this point we --

24 Q Well, not at that point. But at the point that --

25 A Oh, yes.

1 Q -- a decision was made to file and issue it on
2 Thursday, it was after the Commission had approved it.

3 A Correct.

4 Q Then just a question of whether they would do it
5 immediately on Thursday or Friday.

6 A Correct.

7 Q So there's really no enforcement concern in that.

8 A That's right, unless they -- again, unless they
9 wanted an opportunity -- if it's a settlement, if they wanted
10 an opportunity to talk to somebody, if there was a
11 coordination issue, whatever it may be. That didn't exist
12 here.

13 Q Now, were you aware that that Thursday, July 15,
14 2010 was also the day that the financial regulatory reform
15 legislation was approved by the Senate? It was going to be
16 voted on, and eventually it was approved?

17 A I'm aware that it was approved that day. I was not
18 aware -- I don't believe we were aware, when we made the
19 decision to bring the case on -- to bring the settlement on
20 Thursday, that it would be voted on. In fact, our
21 understanding was that it would not be voted on on that day.
22 I think most of us believed it was probably going to happen
23 later.

24 Personally, I was surprised that they both -- my
25 recollection is there's a cloture vote and then it was

1 approved. I remember being surprised, and discussing with
2 others that we were surprised, that it actually was approved
3 that day.

4 Q Okay. But you did see that when the press reports
5 came out, it was sort of a double story: SEC settles with
6 Goldman/financial regulatory from approved?

7 A I observed that.

8 Q And was that a concern --

9 A That certainly wasn't anybody's aim.

10 Q Was that a concern just in terms of perception,
11 given the previous complaint?

12 (b)(7)(C) Which previous complaint?

13 BY MR. KOTZ:

14 Q There was a complaint by Congressman Issa, which is
15 what we're investigating, one of the things, that the action
16 against Goldman Sachs was done to financial regulatory
17 reform. And here the settlement is almost a joint story with
18 the financial regulatory reform going through.

19 A Yes. I think the story about -- the story about --
20 we were, of course, attuned to when the reg reform was going
21 to pass because it imposed significant responsibilities on
22 the SEC. So in light of -- and yes, in light of Congressman
23 Issa's letter, people were concerned about that.

24 But, quite frankly, as of the time the action was
25 approved and our expectation for when we were going to bring

1 the settlement, we believed it was not going to coincide. So
2 in other words, we didn't actually think it was going to play
3 out that way. So we were surprised.

4 Q But just to be clear, essentially the filing and
5 announcement of the Goldman settlement, and the vote to
6 approve financial regulatory reform's timing, was a
7 coincidence?

8 A Oh, yes. That was definitely a coincidence.

9 Q Now, you mentioned earlier that you had worked on
10 financial regulatory reform issues?

11 A Uh-huh.

12 Q Yes?

13 A Yes.

14 Q And is it fair to say that the SEC, or the Chairman
15 particularly, was generally in favor of financial regulatory
16 reform going through?

17 A Yes. I mean, I just want to -- I'm only hesitating
18 because there's a ton of stuff --

19 Q There were parts they are more in favor of than
20 others.

21 A Yes. There's a lot of stuff in it.

22 Q But all things being equal, I think the Chairman's
23 on record as saying she thought it was a good thing?

24 A That's correct.

25 Q And did you have communications with members of

1 Congress or staff of members of Congress about financial
2 regulatory reform?

3 A Yes. Just from a timing perspective, I want to
4 make sure there's no confusion in the record, not -- most of
5 my communications -- not necessarily at the same times we
6 were considering the things that you're looking into.

7 Q All right. Well, let me --

8 A But yes. Over the period of the last year and a
9 half, I've had a number of conversations with congressional
10 staff related to that bill.

11 Q In any conversation you ever had with congressional
12 staff about financial regulatory reform, did the subject of
13 the Goldman investigation and/or lawsuit come up prior to
14 Goldman being filed?

15 A Never prior to Goldman being filed.

16 Q Subsequent to Goldman being filed, in any of the
17 conversations you had with congressional staff, did the
18 subject of the Goldman settlement come up prior to the
19 Goldman settlement being filed?

20 A Never.

21 Q Did you ever have any communications with the White
22 House regarding financial --

23 A I'm sorry. I can't -- the only caveat I would give
24 is after the Goldman case was filed, there was a phone call
25 that I listened in to. I didn't participate. I was present

1 regulatory reform legislation?

2 A No.

3 Q Are you aware of any information indicating that
4 the SEC's action against Goldman Sachs, or the timing of that
5 action, was related or to advance financial regulatory reform
6 legislation?

7 A No.

8 Q Are you aware of any information indicating the SEC
9 coordinated its action against Goldman Sachs with the
10 Executive Office of the President, the White House, or any of
11 its employees?

12 A No.

13 Q Are you aware of any information indicating that
14 anyone at the SEC shared any information concerning its
15 Goldman Sachs investigation with the Executive Office of the
16 President, the White House, or any of its employees prior to
17 the complaint being filed?

18 A No.

19 Q Are you aware of any information indicating the SEC
20 coordinated its action against Goldman Sachs with any members
21 of Congress or any congressional employees?

22 A No.

23 Q Are you aware of any information indicating that
24 anyone at the SEC shared any information concerning its
25 Goldman Sachs investigation with any members of Congress or

1 any congressional employees prior to the complaint being
2 filed?

3 A No.

4 Q Are you aware of any information indicating th SEC
5 coordinated its action against Goldman Sachs with the
6 Democratic National Committee, the Democratic Senate Campaign
7 Committee, the Democratic Congressional Campaign Committee,
8 or any of their employees?

9 A No.

10 Q Are you aware of any information indicating that
11 anyone at the SEC shared any information concerning its
12 Goldman Sachs investigation with the Democratic National
13 Committee, the Democratic Senate Campaign Committee, the
14 Democratic Congressional Campaign Committee, or any of their
15 employees prior to the complaint being filed?

16 A No.

17 Q And with respect to the settlement with Goldman,
18 are you aware of any information indicating that the SEC
19 coordinated the Goldman settlement with the Executive Office
20 of the President, the White House, members of Congress,
21 congressional employees, the Democratic National Committee,
22 the Democratic Senate Campaign Committee, or the Democratic
23 Congressional Campaign Committee, or any of their employees?

24 A No.

25 Q And are you aware of any information indicating

1 that anyone at the SEC shared any information concerning the
2 Goldman settlement with the Executive Office of the
3 President, the White House, its employees, members of
4 Congress or congressional employees, or the Democratic
5 National Committee, the Democratic Senate Campaign Committee,
6 the Democratic Congressional Campaign Committee, or any of
7 their employees?

8 A No.

9 (b)(7)(C) Prior to it being filed?

10 BY MR. KOTZ:

11 Q Prior to it being filed?

12 A I'm not aware of any such information.

13 Q Have you had communications at all with the
14 Democratic National Committee, the Democratic Senate Campaign
15 Committee, or the Democratic Congressional Campaign
16 Committee?

17 A No.

18 (b)(7)(C) At all?

19 THE WITNESS: Ever in my life?

20 BY MR. KOTZ:

21 Q Well, in connection with your duties at the SEC?

22 A In relation to my duties, no.

23 Q Are you aware of any information indicating
24 specifically that anyone at the SEC shared any information
25 concerning the Goldman Sachs information or the Goldman

1 settlement prior to those matters being filed?

2 A I'm sorry?

3 Q Are you aware of any information indicating that
4 anyone at the SEC shared any information with the news media
5 or journalists concerning either the Goldman Sachs
6 investigation before it was filed or the Goldman Sachs
7 settlement before it was filed?

8 A No.

9 Q I mean, you're aware generally that they were
10 released, but you're not aware specifically of anyone who
11 provided any information?

12 A Correct.

13 Q And you don't know necessarily that the leaks came
14 from the SEC?

15 A Nor am I aware -- that's right. That's why -- that
16 was a part of my "No," was that point.

17 Q Although if it came from a closed Commission
18 meeting, the vote, do you think it was likely that it came
19 from somebody with the SEC? Who else would know?

20 A If there were details about the discussions of the
21 Commissioners, it would have to come from someone at the SEC.

22 MR. KOTZ: All right. Why don't we take a minute
23 and see if we have anything else. Let's go off the record.

24 (A brief recess was taken.)

25 MR. KOTZ: Back on the record.

1 BY MR. KOTZ:

2 Q Just to clarify one matter, looking back on it now
3 with hindsight, knowing the effect that the filing of the
4 Goldman action had on the market and had on Goldman stock, do
5 you think it would have been advisable, had the SEC realized
6 that impact, to file and announce the SEC action against
7 Goldman not during trading hours?

8 A I think -- let me answer like this. I think there
9 is good reason to think about the question of whether it's
10 appropriate to file cases like this during market hours. I'm
11 reticent -- I've thought about this some, and I know others
12 have thought about it.

13 I'm reticent to say that there ought to be a policy
14 or a rule because courts are open during -- it would be very
15 hard to have a blanket policy that we can only bring our
16 cases before or after market hours because that's just not
17 always feasible.

18 So I think it's worth thinking about that question
19 when we file actions, but I don't know if it would be a good
20 blanket policy.

21 Q Right. But you could have a flexible policy. But
22 the fact is, as part of the policy, would be a consideration
23 of the impact on the market or the impact on a particular
24 stock. Right? I mean, you could have --

25 A I think that's worth thinking about.

1 Interestingly, when I've talked about this issue, we
2 affirmatively don't -- in a way, we don't think classically
3 about the effect on the markets when we file actions because
4 we're not looking to influence -- whenever you think about
5 effect on the markets, there's two sides to it.

6 So we don't -- we're usually neutral about it. We
7 bring our case when it's ready, and we file it, and it has
8 its effect. I'm not saying that that's good or bad policy.
9 I'm not putting a value judgment on it.

10 I'm just saying, classically, we were intentionally
11 neutral about that; they were filed when they were filed. I
12 think this is a unique circumstance that showed there can be
13 an effect on the market, and it does raise -- it's worth
14 thinking about the question of whether, in certain
15 circumstances, we ought to consider whether -- when it's
16 appropriate to file an action.

17 I haven't formed in my head yet what -- how that
18 would be best applied.

19 Q And at least when the settlement was filed, the SEC
20 wasn't neutral in the sense that a decision was made to file
21 and announce it after trading hours?

22 A That's correct.

23 MR. KOTZ: All right. Is there something you
24 wanted to add or clarify from your testimony?

25 THE WITNESS: Yes. There were just two or three

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

In the Matter of:)
) File No. OIG-534
OIG-534)

 COPY

Witness: Number 38

PAGES: 1 through 61

PLACE: Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C.

DATE: Thursday, August 12, 2010

The above-entitled matter came on for hearing, pursuant
to notice, at 10:12 a.m.

Diversified Reporting Services, Inc.

(202) 467-9200

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C O N T E N T S

1			
2			
3	WITNESS:		EXAMINATION
4	Myron Marlin		4
5			
6	EXHIBITS:	DESCRIPTION	IDENTIFIED
7	1	Confidentiality and	
8		Nondisclosure Agreement	6
9	2	E-mail chain 11/4/2009, 6:32 p.m.	11
10	3	E-mail chain 11/4/2009, 8:12 p.m.	11
11	4	E-mail chain 1/4/2010	14
12	5	E-mail 1/24/2010	15
13	6	E-mail 1/26/2010	16
14	7	E-mail chain 3/21/2010	19
15	8	E-mail 4/11/2010	20
16	9	E-mail chain 4/14/2010, 10:12 a.m.	22
17	10	E-mail chain 4/14/2010, 6:08 p.m.	29
18	11	E-mail 4/15/2010, 12:07 p.m.	31
19	12	E-mail chain 4/15/2010, 9:44 a.m.	33
20	13	E-mail 4/17/2010	36
21	14	E-mail chain 4/18/2010	38
22	15	SEC Administrative Regulations	40
23	16	E-mail chain 4/16/2010	42
24	17	E-mail chain 7/14/2010	47
25			

1 BY MR. KOTZ:

2 Q Do you remember -- Steve Cohen says, "I flagged the
3 issue we discussed," and he will discuss with Rob. "I'll
4 raise it again at the end of the day. Let me know how
5 strongly you feel." He prefers to file Monday. Do you
6 remember what the issue was?

7 A No.

8 Q I think that there was a discussion about when to
9 file the case, whether to file the case on Thursday, Friday,
10 or Monday. And I think there was kind of a debate between
11 various folks on whether you would want to file a case like
12 this on Friday.

13 A Back in January?

14 Q Yep.

15 A I have no recollection of that whatsoever.

16 Q Okay.

17 A Is there anything you can tell me that might remind
18 you?

19 (b)(7)(C) Is it possible that the issue you
20 discussed with Mr. Cohen about whether waiting to file until
21 Monday might result in a leak or the news media getting the
22 story out before the complaint is actually filed?

23 MR. KOTZ: Yeah. I think that's what Steve Cohen
24 testified.

25 THE WITNESS: That's a common -- that's a common

1 thing we talk about, where big cases you don't want to hold
2 until over the weekend. That's true. I don't have any
3 recollection of this case being sort of ready to go or
4 anything like that back in January. I just kind of remember
5 something must have been up, because I remember being briefed
6 about it months earlier. And as you can see, it's because I
7 guess it was ready to be calendared at some point back in
8 January.

9 BY MR. KOTZ:

10 Q And were you aware that the Chairman at this time
11 was anxious to have Goldman case brought?

12 A I mean -- no. No.

13 Q And then in addition to discussions about whether
14 you want to hold a case over to Friday, were there also
15 discussions about whether it is advisable to file an
16 enforcement case that's going to get some press attention on
17 Friday?

18 A Can you ask the question again? I'm sorry.

19 Q In testimony in this case we've had, you know,
20 maybe ten, fifteen witnesses. And they've all discussed the
21 fact that there was this running debate going on as to
22 whether you would file an enforcement case on Friday because
23 of -- evidentially, traditionally, the enforcement division
24 never filed any big cases that would get any press attention
25 on Friday, with the idea being you'd get less press attention

1 or will discuss."

2 A Right.

3 Q What was that about?

4 A That was about whether or not to do a press
5 conference or some other kind of event other than a press
6 conference. And the issue there was the fact that there are
7 folks who believed this was a narrow case, that we could be
8 criticized for bringing such a narrow case after a two-year
9 investigation and that we could be accused of hyping it if we
10 did a press conference. So this was one of these things
11 where some people were saying, let's have a press conference;
12 some people were saying, let's not.

13 Q What was your view?

14 A Have a press conference.

15 Q How come?

16 A It's just -- it's the Goldman case. I don't know.
17 It seems like it would be a big case. People would want to
18 know about it.

19 Q All right. So do you remember the sequence of
20 events that week that the Goldman case was filed? The
21 Goldman case was filed on a Friday, April 16th.

22 A Right.

23 Q And there were numerous matters going on during
24 that week.

25 A Correct.

1 Q There was this Quadrangle case. Do you remember
2 that one?

3 A Yes.

4 Q Okay. And there were efforts to coordinate when to
5 file what. Is that fair? Or when to announce what?

6 A Yes, although many things were out of our control.

7 MR. KOTZ: Right. All right. Let me show you the
8 next document, this one, Exhibit 9. It's an e-mail exchange
9 between you and John Nester, 4/14/2010 at 10:12 a.m.

10 (Exhibit No. 9 was marked for
11 identification.)

12 THE WITNESS: Okay.

13 BY MR. KOTZ:

14 Q So I assume when you say G's you're referring to
15 Goldman?

16 A Yes.

17 Q Okay. And so how was the decision made to file
18 Goldman on Friday that week?

19 (b)(5)
20
21

22 Q Why couldn't you do it on Thursday when the
23 Quadrangle case is?

24 A (b)(5)

25 (b)(5) My own view was that with

1 Quadrangle on Thursday, together to with as Nester refers to
2 a press conference on the Hill, it just doesn't make sense to
3 have yet a third story on Thursday, so we moved to Friday.

4 Q Okay. And so why would there be a concern about
5 having too many stories on one day?

6 A It's just too much for the press to cover anything.
7 You already have two stories that you want to have -- get
8 attention for. So now all of the sudden bringing Goldman, it
9 ends up creating a problem for the press covering anything.
10 They can't cover everything. So you already had two stories,
11 and these were both two stories that might not necessarily
12 generate, you know, good press on their own. We would have
13 to do a little bit of -- what's the right word? -- outreach
14 to ensure that the people actually would cover those other
15 two stories.

16 Q Which other two?

17 A Quadrangle and the press conference on the Hill
18 with the former Chairman.

19 Q Okay. But you wouldn't need to do that for the
20 Goldman case?

21 A I think Goldman would generate its own press.

22 Q So is there a benefit to have only Goldman on that
23 day, on a one particular day? If it generates a lot press
24 than kind of the media would be saturated with --

25 A No. It's just simply Friday was not a busy day.

1 discussed. I don't know. It's possible somebody said it
2 some point, but I think it wasn't really an issue. I think
3 for me the issue was, you know, Thursday or Friday, Friday or
4 Thursday. That was it.

5 Q And did anyone disagree with the decision to move
6 Goldman Sachs to Friday, among people you spoke with?

7 A The only person I remember pushing back a little
8 was Rob, because he thought that the Stanford report would
9 overshadow the Goldman case.

10 BY MR. KOTZ:

11 Q And so who made the ultimate decision to file
12 Goldman on Friday?

13 A In this case, Mary made the ultimate decision, just
14 because we worked -- it worked its way up to her.

15 Q Okay. But it was sort of a consensus opinion,
16 other than what you mentioned about Rob?

17 A Well, Rob I think also agreed that it didn't make
18 sense to bring it on Thursday. I'm not aware of anybody
19 who -- I'm not aware of anybody who thought Thursday was the
20 better day.

21 Q And why did Quadrangle move from Wednesday to
22 Thursday?

23 A I have no idea.

24 Q But I mean was the SEC able to have any flexibility
25 with Quadrangle? I mean could they have done Goldman on

1 on Tuesday night that I walked into, and somebody indicated
2 to me that it shifted. Because I was going into that meeting
3 thinking it was going to be filed Wednesday, and I knew that
4 there was a lot of work that we still had to do. And I just
5 was like, we still have a lot of work. And somebody said,
6 well, actually it's going to be filed Friday.

7 Q And did they say why?

8 A My recollection was there was some sort of dispute
9 over the redaction issues.

10 Q And was there any thought that the positive press
11 on Goldman would overshadow the press on Stanford?

12 A On Tuesday? No. I don't think anybody was
13 thinking about Goldman at that point.

14 Q But when it came to a point where it looked like
15 both would be on Friday, was there a discussion that that
16 might happen?

17 A I actually initiated some conversations, because
18 that was a concern that I had, that we would be criticized
19 for bringing it on the same day.

20 Q But at that point things were already fixed, in
21 terms of when things would be filed?

22 A At which point are we talking about?

23 Q When you're expressing this potential concern about
24 having Stanford and Goldman on the same day.

25 A No. That -- actually, Goldman wasn't yet fixed.

1 Wednesday morning Quadrangle and the press conference on the
2 Hill was fixed.

3 Q For Thursday?

4 A For Thursday. Stanford was fixed for Friday. The
5 only question was now Goldman Sachs. The obvious decision
6 initially, knee jerk reaction, is well, not Thursday, Friday.
7 But then ultimately the only reason we had discussions was
8 because of the possible criticism we might have. And so if
9 it wasn't for the Stanford report on Friday Goldman would be
10 filed on Friday and there'd be virtually no discussion.
11 Everybody would be like, obviously that makes sense.

12 The only reason I think we had discussions and
13 ultimately elevated it to Mary's level was because of this
14 concern that some people might criticize us for bringing it
15 on the same day. I think ultimately everybody realized, A,
16 Thursday's still not a good day and, B, they're going to
17 criticize us if we file it on Thursday, or if we file it on
18 Friday. Or if things are reversed they'll still raise the
19 criticism. So we just decided to do what we thought was
20 right anyway.

21 Q And Thursday was kind of out, so really it would
22 have been Friday or Monday at that point. Right?

23 A As I said, I don't remember Monday being a serious
24 focus.

25 Q Okay. Okay. So the idea would be if you're

1 worried about criticism that you're filing Goldman and
2 Stanford on the same day you could move Goldman back to
3 Thursday. But you had the other issues with Quadrangle.

4 A And the realization that if they're going to
5 criticize us for filing it on Friday they could criticize us
6 on Thursday as well.

7 Q What about the sense that since the Stanford report
8 has some information in it that was critical of the SEC that
9 it might be good for the SEC if a good news story came out on
10 the same day?

11 A I mean that's a byproduct of having it be on
12 Friday, but the reason for moving it was Quadrangle and, to
13 my mind, I guess the press conference.

14 BY (b)(7)(C)

15 Q Is it fair to say that it was Mary Schapiro's
16 decision to file the Goldman Sachs complaint on Friday?

17 A I mean only because it ultimately elevated to her
18 level you can say that. But as I said, I don't know that
19 anybody really had a different view.

20 MR. KOTZ: Okay. All right. Let me show you the
21 next document. It's an e-mail exchange between you and
22 Stephen Cohen, Eric Spitler, and Didem Nisanci at the top
23 4/14/2010, 6:08 p.m., which we'll mark as Exhibit 10.

24 (Exhibit No. 10 was marked for
25 identification.)

1 have a party that nobody shows up for on Quadrangle.

2 So I think he said, let's just do call outs instead
3 to individual reporters. I'm pretty sure that around that
4 time I stopped in at Didem's office and mentioned the fact
5 that we were just doing call outs, and she reminded me, as
6 she occasionally does, that Louise has contacts in Cuomo's
7 office; make sure you have Louise on your call out list. So
8 my recollection is I went back and I said, just confirming,
9 is Louise Story on your call out list.

10 BY (b)(7)(C)

11 Q In your experience at the SEC so far, have there
12 ever been any occasions in which journalists or media outlets
13 have been given advance notice that a complaint was coming,
14 with the understanding that they would have to hold the
15 story, but just to give them time to get something ready?

16 A I think the most you can do is just say,
17 something's coming down the pike. I don't think you can say
18 a particular case is coming down the pike. So you might say,
19 be by your desk in two hours; something big is coming down.
20 I guess I'd have to check with Becker, Khuzami, or somebody
21 else to see if you can actually go the next step and say what
22 the case is. I don't think you can do that.

23 Q Okay. But at least in your experience that's never
24 occurred?

25 A As far as I know.

1 Q Okay.

2 A I don't recall it happening. No.

3 MR. KOTZ: Okay. All right. Let's go to the next
4 document. I'm going to mark it Exhibit 12, an e-mail
5 exchange that starts with an e-mail from Stephen Cohen to
6 (b)(7)(C) you, and John Nester, 4/15/2010, 9:44 a.m.

7 (Exhibit No. 12 was marked for
8 identification.)

9 THE WITNESS: Okay.

10 BY MR. KOTZ:

11 Q You prepared the timeline for the activities on
12 Thursday and Friday of that week?

13 A I did. Yes.

14 Q Okay. And what's the purpose of that?

15 A There were so many balls up in the air, and I just
16 was -- I was of the mind that maybe the right hand didn't
17 know what the left hand would be doing, and I just wanted to
18 make sure everybody was aware of when everything else was
19 happening.

20 Q And this you did at 2:38 in the morning.

21 A Yeah.

22 Q Now, Stephen Cohen asks, "Why file GS tomorrow at
23 9:30? Sometimes things are not always that smooth when
24 filing. Why not give it a little more lead time, 9:00?"

25 (b)(7)(C) says, "Clerk's office opens at 8:30." Stephen

1 a discretionary decision to file at a different time?

2 A I'm sorry. In this case beforehand?

3 Q No. Afterward.

4 A I don't remember the -- I don't remember the
5 conversation being, okay, let's figure out what we do going
6 forward. It was more like, did we do something that we
7 shouldn't have done in this case, and the answer was, as far
8 as I understood, no.

9 Q Because there was no policy in place on the issue?

10 A I don't know what the -- I just remember calling
11 David and saying, any concern here. And he said, no, you
12 can -- we file all of our cases pretty much during the
13 trading day.

14 Q Were you aware that when the SEC filed the
15 settlement it did it after the trading day?

16 A Yes.

17 Q Was that a conscious decision?

18 A From what I can recall it was. Yes.

19 Q For what reason?

20 A The way I recall it is either Lorin or Rob said, I
21 think we should just do it after the trading day. Because I
22 remember saying, wait a second, do we -- is there some rule
23 now that we need to do this. I didn't know that. And
24 they're like -- I can't remember if it was Rob or Lorin who
25 just said, I think, you know -- I'm sorry. I think what it

1 was I said, David had told me we don't need to file it, you
2 know, after -- just cases in general, after the trading
3 hours. And they said, no, we know that, but we feel like we
4 should do that in this case.

5 Q Okay. Did they say why in this case?

6 A No.

7 MR. KOTZ: Were you aware that in connection with
8 the settlement, while the settlement was filed after the
9 trading day, there was, I guess, some kind of an announcement
10 to the press before the end of the trading day that something
11 was coming? I guess you do that because you actually
12 announce a case.

13 (b)(7)(C) A press advisory it's sometimes
14 called.

15 THE WITNESS: I'm sorry. Say that again.

16 BY MR. KOTZ:

17 Q There's something called a press advisory that you
18 do before you actually announce something. Is that right?
19 That you have to contact press to let them know that you're
20 going to have some kind of announcement?

21 A Right. I mean but that -- it doesn't have to be
22 before the press release. It could be after the press
23 release, if that's what you're talking about. I mean to
24 alert reporters that there's a press conference coming?

25 Q Right. Well, we understand that when the SEC filed

1 A I think Thursday morning.

2 Q Okay. Now, we heard there was some discussion
3 about perception, given the fact that there was a complaint,
4 which we are now investigating, that the Goldman case was
5 brought to influence financial regulatory reform that it
6 would look bad if the SEC filed this Goldman settlement on
7 the day of the, you know, ultimate act relating to financial
8 regulatory reform. Do you remember those discussions?

9 A I don't know which discussions. I just know I too
10 thought it was going to be perceived poorly if we end up
11 doing it on the same day as a reg reform passes.

12 Q Right. And so was there any discussion about
13 perhaps pushing the Goldman settlement to Friday? It
14 wouldn't have been very long. I mean as it is, you were, you
15 know, trying to get it out Thursday evening.

16 A Yes. Yes. There was.

17 Q Okay. And so what was that discussion?

18 A I went into the Chairman's office right before the
19 advisory went out and said, this timing is just unfortunately
20 a bad coincidence, and would it make sense to just hold this
21 until Friday. And a number of folks talked about it. And we
22 all said, wait a second; if we hold it to Friday people will
23 then be able to say we held it because of reg reform.

24 So the thinking was the day before we made the
25 decision. It was done unaffiliated with anything else, other

1 than just it was in the best interest of the SEC to bring it
2 Thursday night, and so we said let's just bring it Thursday
3 night. It was the same sort of issue as previously, which
4 was the next day people would still criticize us.

5 Q Right. Although, I mean, you are aware that when
6 the story came out it was literally a slash headline. It was
7 Goldman Case Settled/Regulatory Reform --

8 A Yeah. Yeah.

9 Q You know --

10 A You never know how these things are going to play
11 out.

12 Q Right. Were you surprised, generally, with respect
13 to the filing of the Goldman action how much press it got?

14 A Yes.

15 Q Okay. Was that, do you think, the general
16 consensus, that folks were surprised at how much press it
17 got?

18 A Yes.

19 Q Okay. Now, you aware of the financial regulatory
20 reform legislation that went through Congress?

21 A Yes. It's been on our plate the whole time I've
22 been here.

23 Q Okay. And what -- did you have a lot of
24 involvement with issues related to it?

25 A Just occasionally reporters would call, and I had

1 help working with John to try to figure out -- or with Eric
2 Spitler, head of legislative affairs -- what the best
3 approach is in dealing with a reporter's questions.

4 Q Did you ever have any conversations with any
5 members of Congress or staff of members of Congress about
6 financial regulatory reform?

7 A No. I don't do that.

8 Q Has anybody at the SEC ever mentioned financial
9 regulatory reform legislation in connection with the Goldman
10 Sachs investigation or in connection with the filing of an
11 action against Goldman Sachs?

12 A Ask the question one more time. Sorry. I missed
13 something there.

14 Q Sure. Sure. Has anybody at the SEC ever mentioned
15 financial regulatory reform legislation in connection with
16 the Goldman Sachs investigation or in connection with the
17 filing of an action against Goldman Sachs? In other words,
18 where they talked about the two somehow being related?

19 A Are you getting back to like beforehand?

20 Q Yeah. Just generally. Generally.

21 A Oh, the criticism has generated discussions.

22 Q Right, right, right. Okay. Yeah. I'm talking
23 about prior to filing the Goldman case.

24 A No. No, no, no.

25 Q Okay. Is it fair to say that the SEC generally was

1 believe that.

2 Q Okay. Are you aware of any information indicating
3 that the SEC's action against Goldman Sachs, or the timing of
4 that action, was related to or to advance financial
5 regulatory reform? Are you aware of any information
6 indicating that that was the case? It's a slightly different
7 question, but not that different.

8 A I'm not -- I think the answer is no to both, so --

9 Q Okay. All right. I'm going to continue with a
10 series of questions now.

11 A Okay.

12 Q Are you aware of any information indicating that
13 the SEC coordinated its action against Goldman Sachs with the
14 Executive Office of the President, the White House, or any of
15 its employees?

16 A No. To the best of my recollection, I do not know
17 that.

18 Q Are you aware of any information indicating that
19 anyone at the SEC shared any information concerning its
20 Goldman Sachs investigation with the Executive Office of the
21 President, the White House, or any of its employees, prior to
22 the complaint being filed?

23 A I'm not aware of that.

24 Q Have you had any conversations with the White House
25 about financial regulatory reform?

1 A I don't believe so. No.

2 Q Have you had any conversations with the White House
3 about the Goldman Sachs case prior to its being filed?

4 A I'm sorry? About the Goldman case? No.

5 Q Are you aware of any information indicating that
6 the SEC coordinated its action against Goldman Sachs with any
7 members of Congress or any Congressional employees?

8 A I'm not aware of that. No.

9 Q Are you aware of any information indicating that
10 anyone at the SEC shared any information concerning its
11 Goldman Sachs investigation with any members of Congress or
12 Congressional employees prior to the complaint being filed?

13 A No.

14 Q Are you aware of any information indicating that
15 the SEC coordinated it's action against Goldman Sachs with
16 the Democratic National Committee, the Democratic Senate
17 Campaign Committee, the Democratic Congressional Campaign
18 Committee, or any of their employees?

19 A No.

20 Q Are you aware of any information indicating that
21 anyone at the SEC shared any information concerning its
22 Goldman Sachs investigation with the Democratic National
23 Committee, the Democratic Senate Campaign Committee, the
24 Democratic Congressional Campaign Committee, or any of their
25 employees prior to the complaint being filed?

1 A No.

2 Q Have you had any discussions with anyone from the
3 Democratic National Committee, the Democratic Senate Campaign
4 Committee, the Democratic Congressional Campaign Committee
5 about say financial regulatory reform?

6 A Say the categories one more time. Just about
7 regulatory reform?

8 Q Right.

9 A Go ahead. Ask the question one more time.

10 Q Have you had any discussions the Democratic
11 National Committee, the Democratic Senate Campaign Committee,
12 the Democratic Congressional Campaign Committee?

13 A No.

14 Q Okay. Are you aware of any information indicating
15 that anyone at the SEC shared any information concerning its
16 Goldman Sachs investigation with the news media or any
17 journalist before the case was filed?

18 A I'm sorry. Ask the question one more time.

19 Q Are you aware of any information indicating that
20 anyone at the SEC shared any information concerning its
21 Goldman Sachs investigation with the news media or any
22 journalist before the complaint being filed?

23 A To the best of my recollection, no.

24 Q I mean you're aware, generally, that there was
25 information leaked out, I assume. But you're not aware

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

In the Matter of:)
) File No. OIG-534
OIG-534)

 COPY

Witness: Number 39

PAGES: 1 through 69

PLACE: Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C.

DATE: Thursday, August 12, 2010

The above-entitled matter came on for hearing, pursuant
to notice, at 2:31 p.m.

Diversified Reporting Services, Inc.

(202) 467-9200

1 APPEARANCES:

2

3 On behalf of the Securities and Exchange Commission:

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5 (b)(7)(C) ESQ., Senior Inspector

6 Office of the Inspector General

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9 Washington, D.C., 20549

10 (b)(7)(C)

11

12

13 On behalf of the Witness:

14 (b)(7)(C) Pro Se

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C O N T E N T S

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WITNESS:

EXAMINATION

4

(b)(7)(C)

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EXHIBITS:

DESCRIPTION

IDENTIFIED

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1

E-mail chain 4/13/2010

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E-mail chain 4/14/2010, 2:19 p.m.

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E-mail chain 4/14/2010, 2:36 a.m.

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E-mail chain 4/15/2010, 8:12 a.m.

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E-mail chain 4/15/2010, 9:44 a.m.

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E-mail dated 4/15/2010, 12:38 p.m.

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E-mail chain 4/15/2010, 7:42 p.m.

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E-mail chain 4/14/2010, 6:08 p.m.

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E-mail chain 4/14/2010, 10:12 a.m.

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E-mail chain 4/18/2010

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E-mail dated 4/19/2010

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E-mail dated 4/20/2010

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SEC Administrative Regulations

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E-mail chain 6/4/2010

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E-mail chain 7/14/2010

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E-mail chain 7/15/2010, 9:55 a.m.

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E-mail chain 7/15/2010, 4:27 p.m.

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24

25

1 a press conference and a press release that went out kind of
2 announcing to the public. So that might give you a good
3 sense.

4 Q Okay. In terms of the external part, informing the
5 public --

6 A Yes.

7 Q Does the SEC Enforcement Division have an interest
8 in having their enforcement cases get press attention?

9 A Yes.

10 Q Okay. And what are the reasons for that?

11 A Deterrents would be one.

12 Q Okay. So explain that a little bit in detail, so
13 we have it kind of for the record.

14 A Sure.

15 Q How would that work?

16 A Right. So, you know, if you have -- we allege
17 wrongdoing in a case, whether it's a settled or a litigated
18 matter, announcing it to the public that the SEC Enforcement
19 Division is -- and then obviously as presented to the
20 Commission, the Commission has decided to pursue that
21 matter -- you know, other entities in the markets will read
22 that press coverage, if you will, and hopefully sit up and
23 take notice and say, okay, well the SEC thinks that this is;
24 you know, the Commission has acted here; they voted; they
25 think that, you know, this behavior is outside the bounds of

1 the securities laws. Therefore we need to make sure that we
2 don't do that.

3 Q Right.

4 A So that's the deterrent effect that we hope to
5 have.

6 Q And what about generally? Is it not a good thing
7 for the Enforcement Division, for the SEC's reputation to, in
8 the press or to the public, to be a good one?

9 A Yes. I think so.

10 Q I mean is there a benefit for the Enforcement
11 Division that the public has confidence in the SEC and the
12 Enforcement Division, that if the SEC or the Enforcement
13 Division has a good reputation then wouldn't people have more
14 confidence in the division and perhaps be more willing to
15 bring complaints to their attention, things like that?

16 A I would agree with that personally. My personal
17 view would be that. So, yes. I think that would make sense.

18 Q And so, you know, there's been some negative
19 attention with the SEC, some related to the Enforcement
20 Division having to do with some reports that our office
21 issued, some other matters. And so do you think that it is
22 important for the SEC if they bring an action that is a
23 significant action for there to be press reports on it, so
24 the public is aware that the SEC is, you know, on the job and
25 doing good work?

1 A That would seem to make sense. Yes.

2 Q Okay. And so it's part of your job to make sure
3 that where the SEC takes an action that it is appropriately
4 communicated outside the building, externally to the public?

5 A Yes.

6 Q Okay. And is part of that job to try to ensure
7 through the media that, you know, the best or whatever
8 appropriate press coverage is given to the SEC's enforcement
9 cases?

10 A I mean I would -- I don't know that I would say a
11 blanket yes or no to that statement. It would be a more kind
12 of complex answer, in that there are many ways, like a press
13 release kind of posted on the website; OPA e-mails out a
14 press release. But frequently then after we do that
15 sometimes, you know, reporters will call in and they will ask
16 for follow-up interviews with the people who did the case or
17 with Rob Khuzami himself. Or I'm sure people call and
18 reporters ask for Mary Schapiro. So I mean there are a
19 number of different kind of levels to -- I think the way you
20 described getting press coverage or whatever. So I mean it's
21 sometimes, you know, multiple layers if you will.

22 Q And so is part of your duties to sort of maximize,
23 you know, positive coverage of the SEC Enforcement Division's
24 actions and accomplishments?

25 A I don't know that I would say maximize, but I would

1 A Because, as when Rob first told me about it, it was
2 a complex -- it was a CDO case, and it was also a
3 mortgage-related case, and we've been doing a lot in the
4 mortgage-related area from, you know, across the spectrum of
5 that industry. So this is yet another one of those, and yes,
6 because it's Goldman Sachs.

7 Q Okay. And then maybe also because it relates to
8 the financial crisis?

9 A That's correct. Yes.

10 Q Okay. So was there a particular interest, given
11 this terrible financial crisis, for the SEC to show to the
12 public that they are bringing actions relating to the
13 financial crisis?

14 A Could you repeat the first part of the question
15 again?

16 Q You know, was there a particular interest on the
17 part of the Enforcement Division, you know, where you have a
18 financial crisis that effects so many people, for it to be
19 important that the SEC shows that it's working on matters
20 related to the financial crisis and bringing actions against,
21 you know, companies or individuals that engaged in
22 wrongdoing?

23 A Yes. And I think that that would always be a
24 priority, you know, whether it's ten years ago or ten years
25 from now, that, you know, whoever enforces the nation's

1 foremost what this is about and a deterrent effect is what we
2 discuss frequently. And since my job is an established
3 communications person for, you know, some years now, you
4 know, I don't want to see negative press befall the agency.

5 Q Right.

6 A So that's my answer.

7 Q But I mean the reputation effect, the reputation of
8 the agency and the Enforcement Division is also important, to
9 have a good reputation, have confidence out there.

10 A Yes.

11 Q And, you know, even in addition to the deterrent
12 effect, isn't it a good thing for the SEC's and Enforcement
13 Division's reputation to have coverage of their good works?

14 A Yes.

15 MR. KOTZ: All right. Let me show you a couple of
16 e-mails, and we'll get into the specifics of what occurred
17 the week that the Goldman case was filed. So I'm going to
18 show you Exhibit 1, which is an e-mail exchange on 4/13/2010,
19 11:03 p.m. beginning from Reid Muoio to (b)(7)(C)

20 (Exhibit No. 1 was marked for
21 identification.)

22 BY MR. KOTZ:

23 Q And so if you could kind of -- you know, just to
24 give yourself a little context, this is Tuesday, April 13th.
25 And eventually the Goldman case was announced and filed on

1 Q And so he says, "I don't know whose idea it was to
2 file Friday, but I know we usually don't." Do you know if
3 you told him whose idea it was to file Friday or you knew at
4 that time?

5 A No.

6 Q All right. So did you have a personal view on
7 whether it was a good idea to file the Goldman case on Friday
8 or perhaps wait until Monday?

9 A I did have a personal view. Yes.

10 Q What was the view?

11 A The view was not to wait for a Monday filing.

12 Q For what reason?

13 A Because of the risk of a leak.

14 Q And explain to me what the consequence of a leak
15 is.

16 A The consequence of a leak is that a story is
17 published in the public, for the public to consume, about a
18 matter that the SEC has acted on without the SEC's
19 explanation of what that matter is.

20 Q And so what would be the consequence of that?

21 A Misinformation. And therefore, you know, a very
22 strong potential of negating or reducing the deterrent effect
23 of the Commission's actions. It's just not the way to
24 proceed.

25 MR. KOTZ: Right. Okay. All right. Let me show

1 A Yes.

2 Q What were those discussions?

3 A I mean generally speaking, I don't remember like
4 specifically who said exactly what words.

5 Q Sure.

6 A But generally speaking, I think it was expressed at
7 this meeting that there was -- that it would be advisable to
8 make the announcement after the close of the market, so as
9 not to impact the market.

10 Q And was that impacting the market overall or
11 impacting Goldman Sachs's stock?

12 A I don't recall specifically. I believe impacting
13 the market overall, but again I don't remember specific words
14 from that discussion.

15 Q And did you agree with that thinking?

16 A I had no problem with it.

17 Q But do you recall that the press advisory was, as
18 indicated on this timeline, prior to the market close, and
19 that because there were all these news reports about the
20 settlement that, in fact, people figured out that this press
21 advisory related to announcement of the settlement, and
22 actually Goldman Sachs's stock was significantly effected in
23 the time period from the press advisory to before the market
24 closed?

25 A Well, I recall that the press advisory was not

1 may give the impression that it is what he thinks it is?

2 A Exactly.

3 Q Now, are you aware of the financial regulatory
4 reform legislation that advanced through Congress generally?

5 A Generally speaking, yes.

6 Q Okay. Did you have any involvement in working on
7 aspects of it?

8 A No.

9 Q Did you have any communications with anyone in
10 Congress, whether Congressional members or staff members
11 about financial regulatory reform?

12 A No.

13 Q Has anybody at the SEC ever mentioned this
14 legislation in connection with the Goldman Sachs
15 investigation or in connection with the filing of an action
16 against Goldman Sachs prior to being it filed?

17 A Could you repeat it just one more time?

18 Q Sure. Has anybody at the SEC ever mentioned the
19 financial regulatory reform legislation in connection with
20 the Goldman Sachs investigation or in connection with the
21 filing of an action against Goldman Sachs prior to being it
22 filed?

23 A No. Not in my presence.

24 Q Do you have any reason to believe that the SEC's
25 action against Goldman Sachs, or the timing of the action,

1 was related to or specifically to advance financial
2 regulatory reform?

3 A No.

4 Q Are you aware of any information indicating that
5 the SEC's action against Goldman Sachs, or the timing of that
6 action, was related to or to advance financial regulatory
7 reform?

8 A No.

9 Q Are you aware of any information indicating that
10 the SEC coordinated its action against Goldman Sachs with the
11 Executive Office of the President, the White House, or any of
12 its employees?

13 A No.

14 Q Have you had a conversation with anyone at the
15 White House in your time at the SEC, as part of your work for
16 the SEC?

17 A No.

18 Q Are you aware of any information indicating that
19 anyone at the SEC shared any information concerning its
20 Goldman Sachs investigation with the Executive Office of the
21 President, the White House, or any of its employees, prior to
22 the complaint being filed?

23 A No.

24 Q Are you aware of any information indicating that
25 the SEC coordinated its action against Goldman Sachs with any

1 members of Congress or Congressional employees?

2 A No.

3 Q Are you aware of any information indicating that
4 anyone at the SEC shared any information concerning its
5 Goldman Sachs investigation with any members of Congress or
6 any Congressional employees prior to the complaint being
7 filed?

8 A No.

9 Q Are you aware of any information indicating that
10 the SEC coordinated it's action against Goldman Sachs with
11 the Democratic National Committee, the Democratic Senate
12 Campaign Committee, the Democratic Congressional Campaign
13 Committee, or any of their employees?

14 A No.

15 Q Are you aware of any information indicating that
16 anyone at the SEC shared any information concerning its
17 Goldman Sachs investigation with the Democratic National
18 Committee, the Democratic Senate Campaign Committee, the
19 Democratic Congressional Campaign Committee, or any of their
20 employees prior to the complaint being filed?

21 A No.

22 Q Have you ever had a conversation with anyone at the
23 Democratic National Committee, the Democratic Senate Campaign
24 Committee, the Democratic Congressional Campaign Committee
25 through your work with the SEC?

1 A No.

2 Q Are you aware of any information indicating that
3 anyone at the SEC shared any information concerning its
4 Goldman Sachs investigation with the news media or any
5 journalist prior to the complaint being filed?

6 A No.

7 Q Now with respect to the settlement, are you aware
8 of any information indicating that anyone at the SEC
9 coordinated the settlement with Goldman Sachs with the
10 Executive Office of the President, the White House, members
11 of Congress, Congressional employees, or any members of the
12 Democratic National Committee, Democratic Senate Campaign
13 Committee, Democratic Congressional Campaign Committee?

14 A No.

15 Q Are you aware of any information indicating that
16 the SEC shared any information regarding its settlement with
17 Goldman prior to it being filed with the Executive Office of
18 the President, the White House, its employees, members of
19 Congress, Congressional employees, or the Democratic National
20 Committee, Democratic Senate Campaign Committee, Democratic
21 Congressional Campaign Committee or their employees?

22 A No.

23 Q Are you aware of any information indicating that
24 the SEC timed the filing of its initial complaint and action
25 against Goldman Sachs to advance financial regulatory reform?

1 A No.

2 Q Are you aware of any information indicating that
3 the SEC timed its settlement of its action with Goldman Sachs
4 with financial regulatory reform legislation?

5 A No.

6 Q Do you believe that it was just a coincidence that
7 the SEC announced and filed its Goldman Sachs settlement on
8 the same day that the Senate voted to approve financial
9 regulatory reform? Do you think it was a coincidence, or do
10 you think that the two are somehow related?

11 A I don't think there was a relation. I have no
12 reason to believe that there was any relation.

13 MR. KOTZ: All right. If you could just give us a
14 second, we're going to go off the record.

15 (A brief recess was taken.)

16 MR. KOTZ: Back on the record. We don't have any
17 further questions. The one thing I would ask -- and this is
18 significant -- is in order to preserve the integrity of our
19 investigation, that you not discuss the content of your
20 testimony with anyone.

21 THE WITNESS: Okay.

22 MR. KOTZ: All right. And we're off the record.

23 (Whereupon, at 3:57 p.m., the examination was
24 concluded.)

25 * * * * *

27

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

In the Matter of:)

) File No. OIG-534

OIG-534)

ORIGINAL

PAGES: 1 through 134

PLACE: Securities and Exchange Commission

100 F Street, N.E.

Washington, D.C.

DATE: Friday, August 13, 2010

The above-entitled matter came on for hearing, pursuant to notice, at 9:33 a.m.

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(202) 467-9200

1 APPEARANCES:

2

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6 Office of the Inspector General

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11

12

13 On behalf of the Witness:

14 ROBERT KHUZAMI, PRO SE

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1 June, July at the latest.

2 Q Of 2009?

3 A Correct.

4 Q And what did you learn about that case initially?

5 A It was in the course of case reviews of significant
6 cases. I learned generally about the investigation, what the
7 focus was. I think at that point we had, you know, developed
8 roughly the legal theory about the case that ultimately was
9 the basis upon which it was brought. And I, you know, chose
10 to make it sort of a high priority. We had an emphasis on
11 credit-crisis-related, mortgage-related, cases, structured
12 products as well, given their role in the credit crisis. So
13 I met with the team and learned about the case in that way.

14 Q And so about how many cases were a high priority,
15 like the Goldman Abacus case?

16 A Well, subsequent to that -- later in the fall we
17 developed a national priority list.

18 Q Right.

19 A I don't think it was intact at that time, at least
20 not formally. When the national priority list -- at that
21 point I think each regional director and maybe each SO in the
22 home office had like a top ten kind of -- top ten and maybe
23 even a top three or both of cases. And that was the way
24 priority cases were kind of communicated up the chain. But I
25 focused more on I wanted a national priority case, so we

1 developed a list. When it was first developed -- and even
2 over time, it's ranged between 60 -- I think it's currently
3 at 59 and ranges between 60 and 80 as some roll off and
4 some --

5 Q And the Goldman Abacus case was one of them on the
6 national priority list?

7 A As soon as the first list came out, yes.
8 Absolutely. And even before that it was a priority.

9 Q Okay. And because of the priority of the case, was
10 it a case that you would brief the Chairman about?

11 A Yeah. Yeah. We have a senior staff meeting on
12 Monday mornings. I had briefed the Chairman on those
13 occasions and others as well.

14 Q How many times would you say you briefed the
15 Chairman on the Goldman Abacus case?

16 A That's going to be difficult to estimate. You
17 know, I suspect I raised it at -- I don't know -- half a
18 dozen to ten senior staff meetings over the course of nine
19 months or a year. And then I'm sure we had a few meetings
20 outside of staff meetings where it was raised. And then as
21 the case got closer to bringing brought there was more
22 conversation.

23 Q Okay. Did she ever express any particular
24 direction about the case to you?

25 A No. Just wanting -- you know, her priorities were

1 the same as ours, so she would want to keep tabs on, but she
2 never really -- and she would ask about where it was. And
3 again, as we got closer she got more involved. But never
4 sort of dictating any direction in that sense.

5 Q What we've understood from various people's
6 testimony and documents is that generally she was concerned
7 about moving cases along and getting cases out, not only the
8 Goldman case but just in general, and that that may have been
9 conveyed with respect to Goldman and other cases. Is that --
10

11 A We shared that view, and she communicated to me, I
12 communicated to her, and we communicated all the way around.
13 And that's frankly -- the national priority list, if you've
14 ever seen it, we require people to set a target date. And
15 then if they slip that target date they've got to tell us and
16 explain why it is it went from, you know, July to October,
17 why the slippage. And that's why we want to monitor.

18 Q Okay. So would you say generally it was both your
19 and the Chairman's view that we should try to move the
20 Goldman and other cases as quickly as possible, assuming that
21 there's appropriate facts in order, etcetera?

22 A Yes. They were priority.

23 MR. KOTZ: Okay. Let me go to the first document.
24 This we're going to mark as Exhibit 1, an email exchange
25 between you and Lorin Reisner. There's an email from Lorin

1 BY MR. KOTZ:

2 Q On the top is an email from John McKown to Cheryl
3 Scarboro, 12/8/2009, 10:58 a.m. And so the email below is
4 where Cheryl Scarboro is telling Joan McKown, with a copy to
5 you and Lorin, "the matter will not be the calendar for
6 December 17th. We will not discuss it at today's 2B
7 meeting." So do you recall the reason that that Goldman
8 Abacus case was taken off the calendar in December?

9 A I think -- it's a little blurred with reasons in
10 January, but my recollection is that we wanted to take the
11 testimony of Jonathan Egol, I think which had not been done.
12 That's the primary reason that I recall.

13 Q Okay. And do you recall that there was sort of
14 internal disagreement? (b)(7)(C) thought that Jonathan
15 Egol's testimony should be taken; Reid Mucio didn't think it
16 was necessary or important. Do you remember that?

17 A That I don't recall.

18 Q Okay.

19 A That I don't recall.

20 Q All right. So you just generally remember that the
21 decision was made to take it off the calendar in order to
22 take Jonathan Egol's testimony?

23 A There may have been just some other reason, about
24 whether or not it was generally otherwise ready, even in
25 terms of drafting the documents and things like that. But

1 Christmas article in the newspaper about Mr. Ego and Goldman
2 Sachs?

3 A I do.

4 Q And you sent an email to Mary Shapiro, Thursday,
5 December 24, 11:42. "It looks like her sources are leaks
6 from ex-Goldman folks rather than from inside the SEC."

7 A Right.

8 Q How did you come to the conclusion that you thought
9 it was not from the SEC?

10 A I think it was just -- I mean it was just the
11 article itself. I'd have to go through it and see, but I
12 vaguely recall, "according to former Goldman employees with
13 direct knowledge of the deals" -- you know, you see that in
14 the fourth paragraph. So that's the reason. It was just
15 based on what was in the article.

16 Q Right. Was there anything in the article that you
17 were concerned came from the SEC's investigation?

18 A I'd have to -- you know, I don't recall, as I sit
19 here. I'd have to sit down and read the article.

20 Q Was it generally a concern, just because there's an
21 investigation ongoing and there's an article out that has at
22 least a similar subject? Was there a concern that it would
23 impact the investigation in some way?

24 A Look, you know, publicity in general isn't a good
25 thing. You want to keep your investigations private and

1 confidential. You don't want witnesses, potential
2 defendants, third parties, reading things that can then color
3 their testimony. So as a general matter, it's not a good
4 thing for an investigation that's trying to remain
5 confidential.

6 Q Okay. But I mean there may be times where there
7 are specific facts that you would see in an article that you
8 would think, wow, the only way that could have come from was
9 from something in our investigation. And that would be more
10 than just kind of generically you don't want to see any
11 report about what you're working on, but a particular
12 concern. Do you remember any particular concern?

13 A You mean in addition to being worried about the
14 integrity of your case you're also worried that someone at
15 the SEC is leaking?

16 Q Right.

17 A Is that what you're saying?

18 Q Right.

19 A Yes. Yes. That's a concern as well. Leaks from
20 our end are, you know, prohibited and don't help the case
21 obviously either.

22 Q But there was -- you don't remember anything in
23 this situation, with respect to the December 29th article or
24 the December 24th article, of some specific fact that you
25 thought may have been leaked from the SEC?

1 put it back on the calendar. Is that your recollection,
2 generally?

3 It was essentially one major investigative step,
4 and then once that was done -- now, of course, depending on
5 what they found that could change this, But based on what
6 they at least at this point found by virtue of the Egol
7 testimony, the determination was okay, we took Egol's
8 testimony, now it goes back on the calendar.

9 A Two things that -- well, I guess I can only answer
10 that with my recollection as to why it ultimately didn't get
11 put on the calendar in January, regardless of whether it was
12 the 8th or the 14th or the 21st.

13 Q But it did get put on the calendar in January, but
14 then it was pulled.

15 A It was pulled. Yeah. Yeah, yeah, yeah. But the
16 reasons were two-fold. One, we discovered that we had no --
17 we did not have the sworn testimony of (b)(7)(C)
18 (b)(7)(C) who was the IKB witness who dealt with Goldman in
19 the case. And when Lorin and I learned -- and I don't recall
20 when we learned, but when we learned that all we had was a
21 proffer and not a sworn either deposition testimony or least
22 an affidavit that concerned us.

23 This is a significant witness in the case; he's
24 overseas. You know, candidly Goldman has influence, as many
25 defendants, so you had to worry very much what if this

1 witness kind of runs for the hills when the case is filed.

2 You haven't got him locked in.

3 Q Right.

4 A And so we were very troubled by that. And then
5 two, yeah, we took Egol's testimony. But the decision --
6 well, I'll put it this way. The need for an affidavit from
7 (b)(7)(C) and it may also have been an affidavit from the
8 ACA witness. I don't know whether or not we had that at that
9 point. We may not have. (b)(7)(C) I believe her name
10 is. We either had hers and wanted (b)(7)(C) or we didn't
11 have either and we wanted to get them both. I don't recall
12 which it was.

13 And as long as we were going to delay to do that,
14 we decided that we would also delay because we needed to make
15 a decision about Egol. Taking his testimony is one thing.
16 Deciding whether or not there was a basis to charge him was a
17 separate matter, and turned out to be a very extensive
18 debate.

19 Q Those were the deliberations that took place around
20 the time in late January, when it was placed back on the
21 calendar and then taken off the calendar. Right?

22 A I think that's right. Whether or not they
23 influenced the earlier scheduling I don't --

24 Q Right. We're still at the stage where, at least at
25 this point in time it looks like it's going to be put on the

1 probably unnecessary. Let's stick with the 21st." Do you
2 know what Reid meant -- why he would think that this was a
3 high-profile matter that recently became time sensitive?

4 A I don't, other than generally -- you know,
5 generally pushing to get it done, I don't know what
6 particular thing he was referring to.

7 MR. KOTZ: Okay. Let me show you some emails.
8 Maybe that will help with the recollection. And I'm going to
9 show you first Exhibit 6, which an email exchange. It starts
10 with an email from you to Eric Spitler, Stephen Cohen, Julie
11 Davis, Lorin Reisner, 1/5/2010, 7:52 p.m.

12 (Exhibit No. 6 was marked for
13 identification.)

14 THE WITNESS: Yes.

15 BY MR. KOTZ:

16 Q Okay. So the email exchange here starts with an
17 email from you to Mary Shapiro, Didem Nisanci, Eric Spitler,
18 Julie Davis, Stephen Cohen, Monday, January 4th, 2010, 1:45
19 p.m. saying that, "I heard that Senator Levin and Senate
20 Permanent Subcommittee on Investigations is preparing to haul
21 Goldman and other banks to a hearing. Late January/February
22 is what I'm hearing." Do you recall hearing that?

23 A Yes.

24 Q How did you hear that? Do you remember?

25 A Well, part of it I knew. I knew that PSI was

1 poking around in this area.

2 Q Right.

3 A Because I knew it frankly from before I came to the
4 Commission. They had been poking around for a while. I may
5 not have the timing right.

(b)(5)

6 (b)(5)

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11 Q Right. Right. And we have an email on that as
12 well.

13 A Yeah.

14 Q But do you remember how you heard that it was late
15 January or February?

16 A The only -- I think from, you know, a couple of
17 defense lawyers out there in the world, you know,
18 ex-prosecutor friends of mine, you know, what's going on and,
19 you know, just chatter like that. That was probably -- that
20 and those other things is probably what I was referring to.

21 Q Okay. And then you say,

(b)(5)

22 (b)(5)

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(b)(5)

What did you mean by that?

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(b)(2),(b)(5)

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11 Q Right.

12 A And second of all, structured products,
13 mortgage-related cases, were a high priority of ours. I also
14 didn't want, you know, the case to be viewed as one we only
15 brought in reaction to what somebody else did.

16 Q Right.

17 A This has been a high priority with us, you know,
18 nearly since I got there. I wanted to be able to bring the
19 case, you know, as quickly as possible, and, you know, based
20 on our own efforts.

21 MR. KOTZ: Okay. And so if you see in the email
22 exchange, Julie Davis responds that she'll be happy to check
23 with PSI staff. She says, "This is somewhat delicate because
24 they likely don't want us to beat them to the punch either."
25 And then you go back talking about January 21st, saying,

1 on Tuesday night that I walked into, and somebody indicated
2 to me that it shifted. Because I was going into that meeting
3 thinking it was going to be filed Wednesday, and I knew that
4 there was a lot of work that we still had to do. And I just
5 was like, we still have a lot of work. And somebody said,
6 well, actually it's going to be filed Friday.

7 Q And did they say why?

8 A My recollection was there was some sort of dispute
9 over the redaction issues.

10 Q And was there any thought that the positive press
11 on Goldman would overshadow the press on Stanford?

12 A On Tuesday? No. I don't think anybody was
13 thinking about Goldman at that point.

14 Q But when it came to a point where it looked like
15 both would be on Friday, was there a discussion that that
16 might happen?

17 A I actually initiated some conversations, because
18 that was a concern that I had, that we would be criticized
19 for bringing it on the same day.

20 Q But at that point things were already fixed, in
21 terms of when things would be filed?

22 A At which point are we talking about?

23 Q When you're expressing this potential concern about
24 having Stanford and Goldman on the same day.

25 A No. That -- actually, Goldman wasn't yet fixed.

1 Friday.

2 A So this -- I'm a little vague on the dates.

3 Q It was put back on the calendar on the 28th.

4 A 28th. I see. Which was that Thursday.

5 Q Right. And so the idea would be when to file it
6 after that.

7 A Right. I mean, you know, candidly I don't recall
8 kind of discussions of focus on when we would file. As a
9 general matter, you know, we file pretty soon after things
10 are approved. But I don't recall being involved in any
11 discussions about that.

12 Q And in this email exchange there is discussion of
13 something that we found was somewhat a debate, I guess. And
14 I don't know whether you were involved in this debate or not.
15 But this idea that conventional wisdom in the enforcement
16 division was not to file a big case on Friday. But that
17 perhaps that may not necessarily be meaningful anymore in the
18 Internet age, where there's a 24/7 news cycle.

19 A You know, I mean that kind of stuff, candidly is
20 kind of an OPA issue on (b)(7)(C) you know. I think I remember
21 from my old -- you know, in the U.S. Attorney's Office that
22 kind of was the view. But it seems to be we filed a bunch of
23 cases on Fridays. If I thought about it I could probably
24 list them.

25 Q Goldman eventually was filed on Friday.

1 A Goldman was filed on a Friday.

2 Q And it did seem to get some news.

3 A Yeah. Right. So I kind of -- you know, I leave
4 that to more of the OPA folks.

5 Q Okay. So I mean, Lorin forwarded this to you, but
6 you don't remember commenting or weighing in on this?

7 A No. No.

8 Q Okay. All right. And so what we show is that it
9 was then placed on the calendar for the 28th and then taken
10 off the calendar.

11 A Taken off.

12 Q And one thing we're trying to get some clarity on
13 -- maybe you can help -- is that there have been several
14 explanations given about why it was taken off the calendar.
15 One related to what you were talking about, about IKB. And
16 also the idea that a decision was made to proceed with the
17 entire case and make whatever determinations were going to be
18 made about Ego1 and then bring the whole case together. Do
19 you remember?

20 A My recollection is as follows. It was first and
21 foremost (b)(7)(C) We were troubled by the absence of sworn
22 testimony in his regard. And that as long as you had to
23 delay it for that reason another benefit is that it would
24 give us an opportunity to consider what to do with Ego1. And
25 the additional point I think is why Ego1 became important.

(b)(5)

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14 Q And do you remember any feedback from Commissioner
15 Casey's office about this general idea that if you were going
16 to bring a case bring it all together? Mary Shapiro
17 testified that she had a conversation with Commissioner Casey
18 where this was expressed, and she sort of said, you know,
19 okay, I understand.

20 A It's possible. You know, we bring lots of
21 corporate cases, obviously, where you don't -- you charge
22 kind of individuals down the road, typically in the
23 settlement context, so it happens, I mean slightly different
24 than this situation. But it's possible. I don't have an
25 independent recollection of it.

1 Q Okay. But do you generally recall that while it
2 was enforcement that pulled it off the calendar itself, that
3 at least it was partially based on some feedback from
4 Commissioners, like Paredes office?

5 A Again, my view is (b)(7)(C) you know, the issues
6 in order of significance was (b)(7)(C) As long as
7 (b)(7)(C) making a decision is an additional reason to
8 have more time, in part because we wanted to make a decision
9 about him. And then it also addressed Commissioner Paredes's
10 concern. Those would be kind of the hierarchy of reasons, I
11 guess.

12 Q Okay. Was there any sort of frustration or
13 disappointment? This was a case that had been pending for a
14 while, we wanted it to get out, and in the end it was
15 delayed.

16 A There was a little bit of that. But again, you
17 know, you got to be -- the case has to be thoroughly
18 investigated, so, you know, that, you know, just trumps
19 everything.

20 Q Okay. And is it fair to say that there was
21 significant work done after the case was pulled in December
22 before it was eventually filed, with respect to the issues
23 that you identified as ones that you have to look at?

24 A I am. Reid went to Frankfurt maybe twice, Reid and
25 maybe others. You know, we had to track down (b)(7)(C) It

1 was not so easy. The Germans were, you know, reluctant, a
2 little reluctant to get involved. And working, negotiating
3 the language of the affidavit that he eventually signed,
4 which I don't think got signed until March maybe. It took
5 some time. And then in that timeframe we're also having lots
6 of debate about Jonathan Egol.

7 Q Okay. So there was a very significant amount of
8 time spent trying to figure out whether to bring a case
9 against Egol?

10 A Running parallel with the -- that and other aspects
11 of the case. I mean, obviously drafting issues and things
12 like that. There may have been additional documents, and as
13 long as we had time we may have been nailing other stuff
14 down. And then there was a parallel track. We were debating
15 Egol.

16 Q Right. And the decision was made initially to
17 Wells Egol. Right? That was done after it was pulled in
18 January?

19 A Yeah. I think so. Because we went to a meeting in
20 maybe March or so with Egol's counsel.

21 MR. KOTZ: Right. Okay. All right. Let me show
22 an email about that, the Egol issue. It's Exhibit 10. It
23 starts with an email from (b)(7)(C) to Mark Adler,
24 3/23/2010, 3:19 p.m.

25 (Exhibit No. 10 was marked for

1 the Chairman's viewpoint? One thing that struck us a little
2 bit was there was actually an email exchange that we saw with
3 her in the December timeframe, where she says, I'm really
4 anxious to get this case out, and then it doesn't go out
5 because, you know, for other reasons. So I mean do you
6 remember anything about her expressing frustration that the
7 case hadn't gone out yet?

8 A No. Look, I mean, she has the same interest that
9 we do in moving priority cases quickly. But to her credit,
10 she has never, in my view, intervened inappropriately, like
11 bring a case before it is due, or things like that. A
12 completely open mind, and if you tell her that we have to do
13 these three things she's never going to second-guess us.

14 Q And is it fair to say you never got any impression
15 at any of the meetings you had with Mary that she had a
16 specific timeline in mind for the Goldman case?

17 A Absolutely not. Just the generalized we'd like to
18 get it out as soon as we can, but no specific timelines.

19 Q Okay. And that generalized we'd like to get it out
20 as soon as we can applied to other cases, I assume, as well.
21 Yes?

22 A Yes. Sorry. I can't nod.

23 Q And one of the other things that she referenced was
24 just wanting to bring actions against individuals when you
25 brought an action against a company. Do you remember her

1 Q Do you have any reason to believe that she might
2 have shared information concerning the Abacus case with PSI?

3 A I don't know one way or the other.

4 Q Okay. But to your mind, there was certainly no
5 coordination between the SEC enforcement division and PSI
6 regarding Goldman matters?

7 A No. In fact, later on, when we brought the case,
8 we tried to, you know, talk them out of holding their
9 hearing, unsuccessfully obviously.

10 MR. KOTZ: Right. Okay. All right. Let me show
11 you this next document, marked as Exhibit 13. It starts with
12 an email from David Rosenfeld to you, Monday, April 12, 2010,
13 3:08 p.m.

14 (Exhibit No. 13 was marked for
15 identification.)

16 BY MR. KOTZ:

17 Q So now we're getting into the week that the Goldman
18 case was filed. And it wasn't the only case that was going
19 on at that time. And there was this Quadrangle case. Do you
20 recall that the Quadrangle case was a significant matter that
21 was about to be announced that week as well?

22 A Yes.

23 Q Okay. And do you recall that there was a lot of
24 back and forth with the New York AG's office about Quadrangle
25 and when it would be announced?

1 10:54 p.m., "This would be Wednesday, Goldman likely
2 Thursday." Do you recall that that was initially the plan,
3 Quadrangle Wednesday and Goldman Thursday?

4 A Yeah. I think that's -- although I don't -- I
5 guess I don't know when the announcement date for Goldman
6 kind of solidified. But I mean my recollection is, as a
7 general matter, we didn't want to do them both on the same
8 day.

9 Q How come?

10 A Well, from my perspective it's too much. I mean,
11 you know, for me doing these things there's a lot of work
12 involved. You can't just get there and read six talking
13 points. You know, you got to answer questions; you got to
14 know the case well. I do an extensive amount of briefing.
15 And so I guess from my perspective that's what I'm most
16 concerned about. Also, as a general matter, I assume the
17 Office of Public Affairs would say you generally don't want
18 to announce two significant cases on the same day.

19 Q Because the press would be diluted?

20 A Yeah. There's that, and there's just the logistics
21 involved in getting it all done.

22 Q And do you remember a particular concern with the
23 New York AG's Office that if you announce the Goldman case
24 the same day you announce this case, Quadrangle, with the New
25 York AG's Office they might view that as sort of one-upping

1 them, or they may be upset that here you're putting another
2 case in on the same day?

3 A I don't really recall that. I mean, as I sit here,
4 I suppose I could see Andrew Cuomo thinking that, but I don't
5 know that it entered into our thinking.

6 Q Okay. All right. And so the next email has a lot
7 of details about Quadrangle, which are not that critical for
8 us. It starts with an email from David Rosenfeld to you,
9 Tuesday, April 13, 2010 8:53 a.m. as Exhibit 16.

10 (Exhibit No. 16 was marked for
11 identification.)

12 BY MR. KOTZ:

13 Q If you could see, there's references here in an
14 email towards the bottom of the page, "We have to get
15 assurance of how we will announce the case together on
16 Wednesday -- we have to nail down time, press release, etc."

17 A Sorry. You're reading from --

18 Q Yeah. So that's here.

19 A Oh, okay. Right.

20 Q Yeah. There's a lot of discussion about the
21 penalty, and so, again, that's not really relevant. But
22 what's relevant for us is that at least on this point on
23 Monday it looks like the plans are in place to announce the
24 Quadrangle case on Wednesday, and as you saw from the
25 previous email, Goldman on Thursday.

1 an email to (b)(7)(C) whose idea was it to file
2 Friday? Thanks. Ken." And Reid says, "Front Office. Just
3 don't know their thinking." I assume when he says Front
4 Office he refers to, you know, you and/or Lorin?

5 A I don't know if he's referring to us or the
6 Chairman's Office.

7 Q Okay. But so these guys weren't -- they didn't
8 know anything about Quadrangle I assume?

9 A Right. Because they weren't working the case.

10 Q So do you recall that you then get -- so initially
11 we were talking about Goldman -- Quadrangle Wednesday,
12 Goldman Thursday. Then you get the word that Quadrangle's
13 moved again back to Thursday. And at that point in time the
14 decision was made to put Goldman on Friday, so you would have
15 Quadrangle Thursday, Goldman Friday?

16 A I'm sure that's right. The only caveat again I
17 would say is I don't know -- the Wednesday, Thursday thing, I
18 just don't know how certain Thursday was with Goldman at some
19 point, just because I remember this not really solidifying
20 until some point into the week.

21 Q Okay.

22 A But certainly as a general matter that's correct.

23 Q And so if you remember, the Commission meeting was
24 on Wednesday for Goldman.

25 A That's right.

1 Q Okay. And then it seems as though, because there
2 was more time now for Goldman, that Lorin actually kept
3 revising the complaint, and eventually revised the complaint
4 up until I think even Thursday night. Do you remember that?

5 A I know he was working on it.

6 Q Yeah. Okay. But is it clear to you that once it
7 was understood that the Quadrangle case would be on Thursday,
8 the decision at that point would be to file Goldman on
9 Friday?

10 A Yes.

11 Q And explain to me why it is that you couldn't file
12 Quadrangle on Friday and Goldman on Thursday. I assume that
13 was because the New York AG's Office was involved in the
14 timing. Were they essentially telling you when the case
15 could be announced?

16 A Yeah. Yeah. And we considered doing a joint
17 presentation with them. So physically we couldn't -- we had
18 to do it when they wanted to do it. And that's another
19 reason why you couldn't do both on the same day. We were
20 actually going to be there with Cuomo. Ultimately we decided
21 not to do that, but that was being discussed at some point, I
22 believe.

23 MR. KOTZ: Okay. All right. Let's go to the
24 actual filings. There's an email from Steve Cohen to (b)(7)(C)
25 (b)(7)(C) Myron Marlin, and John Nester, 4/15/2010, 9:44 a.m.,

1 evening. I'm going to show you an email that references
2 that. It's an email exchange that starts with an email from
3 Lorin Reisner to Reid Muoio, Myron Marlin, Ken Lench,
4 4/15/2010, 7:42 p.m.

5 (Exhibit No. 21 was marked for
6 identification.)

7 BY MR. KOTZ:

8 Q Do you remember this conference call? It says you
9 are able to participate.

10 A Okay. I see it.

11 Q Do you remember this conference call?

12 A I believe I participated from my hotel room in New
13 Orleans.

14 Q Okay. Do you remember anything specific that was
15 discussed? Was it more just logistics?

16 A I think it was logistics, and I wanted to get some
17 talking points for the Goldman call the next morning. We did
18 a reporter kind of call in thing.

19 Q And so at the end of the day, what is your
20 understanding as to who made the decision to go with
21 Quadrangle on Thursday and Goldman on Friday? Was that your
22 decision? Was that from the Chairman's office? Was it sort
23 of a combined thing?

24 A It wasn't really our -- I mean I don't recall it as
25 being my decision, except to the extent it was dictated by --

1 from my perspective, dictated by two events: Quadrangle had
2 to be Thursday, and I needed, you know, time to prepare,
3 given the schedule and traveling. So I think those were my
4 concerns. The actual decision as to when to do it, I think
5 it's more OPA. But obviously they include our views in that.

6

7 Q Right. Was there any discussion about perhaps
8 waiting until Monday, give you even a little more time. And
9 then there's always this kind of conventional wisdom issue
10 about filing a big case on Friday.

11 A I don't think it was -- I don't think Monday was
12 seriously considered, just because of the passage of time.

13 MR. KOTZ: Right. All right. Let me show you an
14 email that may relate to that. And so this is an email from
15 Myron Marlin to Steven Cohen, Eric Spitler and Didem Nisanci,
16 4/14/2010, 6:08 p.m. We're going mark this Exhibit 22.

17 (Exhibit No. 22 was marked for
18 identification.)

19 BY MR. KOTZ:

20 Q So this references an email that Scott Friestad
21 sent out to you and a few others, about a reporter who knows
22 the recommendation is on the calendar today.

23 A Yeah.

24 Q Do you remember that, that it looked like somebody
25 knew something?

1 A I do remember. I do remember this, which may have
2 been a reason why we wanted to move -- it was somebody from
3 -- it was one of the wire services I thought, maybe Reuters
4 or Bloomberg, or one of those folks. And I do I think
5 remember that it just gets people a little spooked that some
6 story is going to break before the case is filed.

7 Q Right. And the longer you wait to actually
8 announce it --

9 A The greater the risk.

10 Q Okay. Now, in all the discussions that you
11 participated in about the timing of the filing of the Goldman
12 case, did financial regulatory reform ever come up?

13 A No.

14 Q Was there any discussion in relation to the Office
15 of Inspector General report on Stanford that you can recall,
16 in terms of why the Goldman case was filed on the day it was?

17

18 A No. No.

19 Q You did know that the plan was to release the
20 Office of Inspector General report on Stanford on that Friday
21 as well.

22 A That I did know. Yes.

23 Q Do you know why the Goldman case was decided to be
24 released in the morning and that OIG case in the afternoon?

25 A Not -- I mean no would be the answer. I mean my

1 case?

2 A I did hear that and over the weekend actually spoke
3 to (b)(7)(C) about it, the Goldman general counsel.

4 Q Okay. What was that conversation?

5 A He had called Friday, I think. And I was
6 traveling, so Lorin -- I think Lorin returned the call. I
7 asked Lorin to return the call. And then Lorin told me what
8 the call was, and then I spoke to (b)(7)(C) I think on Saturday
9 and maybe again on Sunday. So between those three
10 conversations I learned that (b)(7)(C) expressed displeasure about
11 really not having a chance to settle the case, that, you
12 know, we have good relations with our regulators; we don't
13 like to get in disputes with them; you know, we would have
14 wanted a chance to settle the case, basically.

15 Q Okay. What did you respond to him?

16 A I said, look, you know, everyone knows you have
17 many opportunities to settle a case; no one stopped you from
18 doing that. Most of our cases, defendants make it clear
19 that, while they may argue aggressively that there should be
20 no finding of liability that, you know, at the same time that
21 they're willing to consider a settlement possibility. And,
22 you know, it's a little -- it's easy to say after the fact,
23 oh, we would have settled.

24 Q Right.

25 A That certainly wasn't the impression we had gotten

1 through the course of discussions with them.

2 Q So let me ask you a few questions on that. Some
3 have said that traditionally, and maybe even prior to your
4 coming to the enforcement division, that as sort of a matter
5 of course when the SEC was bringing a case against a
6 defendant after the Commission had approved the
7 recommendation to go forward with the case a call would be
8 placed to the defendant and the defendant's lawyer to say,
9 the Commission has approved it, and you now have 48 hours or
10 X number of hours to try to resolve it. Did you understand
11 that that was sort of what enforcement division had
12 traditionally done?

13 A I guess that I understood that that can happen, and
14 did happen, but that it wasn't something that was dictated as
15 a mandatory part of our approach.

16 Q Okay. But did you get the impression that
17 oftentimes that did happen?

18 A I don't know about often, but I certainly
19 understood it happened.

20 Q Okay.

21 A And might well happen in response to a defendant
22 along the way saying, if it gets approved, just I'm putting a
23 marker down, I'd like to talk settlement.

24 Q Now, do you think as a practice that that is a good
25 policy to have?

1 A To require it?

2 Q Right. Or let's say to do it in every case?

3 A Do it in every case? I don't think it's such a
4 good idea, because, you know, if that becomes a standard part
5 of our practice then every defendant kind of knows they have
6 a last chance. Right? Nothing -- you know, they can fight
7 like hell and oppose, oppose, and they're always going to
8 have one last clear chance to settle the case. I think
9 appearance-wise it makes you appear like your maybe a little
10 weak, don't believe in your case. That's not to say that
11 it's not appropriate in a lot of cases, maybe most cases.
12 But I would want the opportunity not to have to do that.
13 Notice -- you know, there's maybe a difference between giving
14 them notice that it's coming versus an opportunity to settle,
15 two different things.

16 Q Right. Well, we'll talk about the notice. It's
17 coming in a second. But do you think in the Goldman case,
18 that in the particular facts of the Goldman case, it would
19 have been a good practice to do that, to call them after the
20 Commission --

21 A I had no reason to believe -- we had no reason to
22 believe they were interested in settling ..

23 Q All right. What was that based on?

24 A Their position in all of our Wells meeting, their
25 position in litigation or in the Wells meeting and the Wells

1 that the defendants and/or their counsel are giving timely
2 advice concerning the action." Were you familiar with this
3 provision?

4 A In a general sense. I can't say that I --

5 Q Was the intention in the Goldman case to give
6 Goldman a notice of the SEC filing its action against Goldman
7 prior to the SEC filed its action?

8 A You know, candidly, it wasn't something that was on
9 my checklist. You know, I wasn't -- it's just not something
10 that I would have focused on. You know, I would assume that
11 the policy would have been complied with, and as I understand
12 it, Sullivan and Cromwell was in fact called.

13 Q But do you understand whether Sullivan and Cromwell
14 was called before the SEC filed its action or after?

15 A I thought it was before.

16 Q Okay. If it in fact was after, would that concern
17 you, as not necessarily adhering to the policy you wanted to
18 adhere to?

19 A Yeah. I mean the policy -- look at a little more
20 closely, but if -- "take all necessary steps to see that
21 defendants and/or their counsel are giving timely advice
22 concerning the action." I mean, yeah. Look, it should
23 happen. I suppose if someone got it five minutes after
24 rather than 15 minutes before, I'm not sure that's of
25 particular consequence. But as a general matter, we should

1 be adhering to the policy.

2 Q Do you think generally it's a good idea in an
3 enforcement case to notify a defendant prior to the case
4 being filed, even if it's only a minute or two prior?

5 A Yeah. Yeah. I do.

6 Q Because of the courtesy?

7 A Just a courtesy. There's no -- we're not in the
8 business of kind of gotcha, so I think that's right.

9 Q Now, was there a specific decision made not to give
10 Goldman that other heads up that we discussed, the heads up
11 after the Commission had approved the recommendation to go
12 forward with the case? I mean was that raised as this would
13 be a time when we would call Goldman and a decision was made
14 not to? Or it just never happened?

15 A I don't recall any of that discussion. And, in
16 fact, I think after I talked to (b)(7)(C) I think I sent an
17 email around asking for kind of the timeline, what happened
18 basically.

19 Q Right.

20 A Because I didn't really -- like I said, it wasn't
21 something I was focused on.

22 Q And you were not involved in any instructions given
23 to Reid Mucio about when to call Goldman to give them notice?

24

25 A No.

1 Q Were you aware of those instructions specifically?

2 A No. Like I said, I just didn't focus on this.

3 MR. KOTZ: Okay. All right. Let's move onto

4 Exhibit 25. It starts with an email exchange between Myron

5 Marlin and John Nester, 4/16/2010, 3:55 p.m.

6 (Exhibit No. 25 was marked for
7 identification.)

8 THE WITNESS: Yes.

9 BY MR. KOTZ:

10 Q Do you remember this issue, an individual from the
11 New York Stock Exchange came forward with concerns that the
12 New York Stock Exchange wasn't given a heads up about the
13 Goldman case?

14 A I do.

15 Q What do you remember about that?

16 A I remember -- I remember this. I remember that --
17 look, there was a significant market impact upon the filing
18 of the case, frankly somewhat surprisingly I will say. And
19 so I recall this inquiry from the Stock Exchange. I recall
20 some general discussion about whether or not this is
21 something we could do, because obviously, you know,
22 communicating in advance that you're going to file a case is
23 potentially a concern from just a confidentiality point of
24 view, and you couldn't -- you wouldn't what they would
25 necessarily do with the information.

1 And I think we thought that his kind of market
2 impact was sufficiently rare that I didn't know that we
3 needed necessarily to adopt a broad policy in this approach.
4 So I think it just kind of -- I don't remember it actually
5 going anywhere. I don't think any commitments were made or
6 policies passed.

7 Q Do you recall that when the settlement of the
8 Goldman case was filed and announced the New York Stock
9 Exchange was informed before then?

10 A No. I recall -- I'll tell you what happened there.
11 I don't want to get ahead of your timeline, but --

12 Q It's all right.

13 A What happened was when we filed the case the Stock
14 Exchange expressed a concern and the FSA -- I spoke to
15 (b)(7)(C) She's head of enforcement at the FSA. And
16 she expressed a little bit of the we would have liked to have
17 known, because I think there was a Goldman individual who
18 worked in London, and I don't remember if they actually had a
19 case they were looking at, but they expressed some general
20 desire to know in advance.

21 When it came time to announce the settlement I
22 thought about the notification issues, because Goldman
23 brought it up as part of the settlement. They wanted to
24 notify the Fed -- they wanted to notify their primary
25 regulators. They wanted to notify the Fed; they wanted to

1 notify maybe Treasury; they wanted to notify FINRA, because
2 FINRA was looking in the same space, you know, investigating
3 the same space.

4 And I thought about the Stock Exchange, whether or
5 not they should be notified, and the FSA, you know, because
6 the issue had been raised, most of it driven by Goldman,
7 because they felt they need -- they didn't want their own
8 primary regulators to read about it in the press. And then I
9 said, well, let me think about that, because maybe we want to
10 be the ones to give the notification rather than you. So
11 what ended up happening is I informed FINRA before the
12 settlement, because they had a companion case, by calling
13 Rich Ketchum. And I notified (b)(7)(C) of the FSA.

14 We didn't -- I talked to trading and market about
15 whether or not we should notify the Stock Exchange. I didn't
16 talk -- I think I called Robert and somebody else called me
17 back. We decided no, there's just no reason. We had no
18 reason to believe necessarily the settlement would have an
19 impact, and it was just fraught with kind of -- that it
20 should be limited to people who have an actual -- other
21 regulators who actually have an interest in the case or are
22 doing the case.

23 BY (b)(7)(C)

24 Q Who in trading and markets?

25 A I don't remember who called me back. I called

1 Robert. I don't remember if he was recused or just couldn't
2 answer. He had a deputy somebody call me back. I just don't
3 remember who it was. But that's what we decided. And then I
4 asked him -- I called Mary about it and told her that we
5 weren't going to tell the Stock Exchange. And I told her
6 that Goldman wanted to talk to the Fed and the Treasury, and
7 we both agreed we're not talking to them. They have no -- if
8 Goldman wants to do it that's up to them, but we don't --
9 it's not appropriate for us to be talking to them.

10 BY MR. KOTZ:

11 Q What about the decision to file the complaint
12 initially against Goldman during trading hours? Was there
13 any discussion at that time about not filing the Goldman case
14 during trading hours, because it might have an impact on the
15 Goldman stock or the market overall?

16 A No. I think, you know, we were all somewhat
17 surprised by the reaction. It did come up for the
18 settlement, but not at the time we filed the case.

19 Q Okay. And so what came up with respect to the
20 settlement?

21 A Goldman expressed a desire not to have it filed
22 during trading hours. And the way it shook out was that, in
23 fact, is what happened. I think we generally didn't see a
24 problem with accommodating that concern, but I don't know
25 that it drove our decision. But I don't really think it did,

1 but it was Goldman's concern that it not be filed then.

2 Q Would you be concerned about volatility in the
3 market that would be caused by an action brought by the SEC
4 or a settlement? I mean is that something that you're
5 concerned about, that there's volatility caused specifically
6 by the announcement of an SEC case or settlement?

7 A You know, it's not something -- those are things
8 I'd rather not take into account. You know, these decisions
9 should be made based on, you know, kind of the merits. But
10 on the other hand you can't really ignore that. You don't
11 want to cause unnecessary harm or volatility. So I guess I
12 don't really have an answer as to a general approach. I
13 would look at it in particular circumstances.

14 Q Okay. Were you aware that the Friday that the
15 Goldman Sachs case was filed initially was the third Friday
16 of the month, and that has a significance for the expiration
17 of options?

18 A Yeah. I didn't know that.

19 Q Okay.

20 A The triple witching hour.

21 Q So you were surprised at how much press attention
22 the Goldman Sachs filing got on that Friday?

23 A I was surprised both by the market reaction and the
24 overwhelming press focus on the case.

25 Q And do you think that that was generally shared by

1 Q So this -- we don't need to get into the specifics,
2 but what we're trying to understand is --

3 A Interesting. I don't remember this. This -- I'm
4 sorry. Let me wait for your question.

5 Q So at this point in time it seems there were
6 already discussions about settlement.

7 A Yeah. I may have been mistaken in my previous --
8 this -- I think this came from my weekend phone calls with
9 (b)(7)(C) when he was talking about the -- he would have
10 wanted to settle the case. In fact, I'm sure that he kind of
11 concluded with, let's talk, because we may be interested.

12 Q I see.

13 A And this is Monday, so that's what -- that's what
14 happened.

15 Q Okay. All right. Let me show you the next
16 document.

17 A I don't think -- I guess mid-May was when things
18 kind of heated up a little, when we had our first-to-face
19 meeting about it.

20 MR. KOTZ: Okay. Well, let me just so you this
21 document. It's an email from you to (b)(7)(C)
22 5/5/2010, 5:11 p.m., Exhibit 27.

23 (Exhibit No. 27 was marked for
24 identification.)

25 BY MR. KOTZ:

1 while we were in discussions.

2 Q And do you think at this stage in mid-June that you
3 were hoping that you would get something finalized within a
4 month or so?

5 A Well, the real -- the -- I don't remember when it
6 was raised, but Goldman made it clear they wanted to for two
7 reasons. One, the answer was due on July 19th. The second
8 thing was their second quarter earnings, their books closed
9 on -- I think their books closed on July 9th, and they were
10 due to report earnings on the Tuesday, the 20th.

11 Q Right.

12 A And so they're going to have to take a big reserve
13 under -- even if there was no final settlement, they might
14 have to take a reserve. And so all of the sudden a big fat
15 number would appear in their books. And we thought, that's
16 going to tell the world that they're getting ready to settle,
17 so I think everybody was of the view that if we're going to
18 get it done it had to get done before those two dates.

19 Q Okay. And how early on did you have an
20 understanding of those two dates? Was that something that
21 came up a week or two before, or was that something that came
22 up sort of a month or two before?

23 A I think it came up -- I think it came up earlier.
24 I don't know -- two months would be no. One month is
25 possible. Somewhere between -- well, obviously it had to

1 be -- it had to be before July 9th, because I remember -- I
 2 think it was (b)(7)(C) said our books close on July 9th.
 3 So it was before July 9th. And my sense it was two weeks to
 4 a month before, something in that area. We can track it down
 5 by -- I think it was (b)(7)(C) who said it in a meeting, a
 6 settlement meeting that he intended. But it's also possible
 7 I learned it before from counsel. So it was not -- something
 8 that we knew for some period of time.

9 Q Okay. And was it helpful, generally, in this
 10 settlement? In other settlements to kind of have a date
 11 that, you know, is looming and then you move things along.

12 A I'm a big believer in deadlines.

13 Q Okay. All right. So at least for a couple of
 14 weeks to a month you had those dates, July 19th or 20th, in
 15 mind as the dates that if you were going to get it done you
 16 wanted to get it done by.

17 A Before that. Yeah. Yeah. Exactly.

18 MR. KOTZ: All right. Let me show you the next
 19 document, Exhibit 29. It's an email. It starts with an
 20 email from Lorin to Ken Lench, you, and Reid Muoio, 7/1/2010,
 21 10:50 a.m.

22 (Exhibit No. 29 was marked for
 23 identification.)

24 BY MR. KOTZ:

25 Q So we don't have to go into all the specifics, but

1 one. Exhibit 31 is an email from Steve Cohen to Myron
2 Marlin, 7/14/2010, 9:58 p.m., which is forwarding or
3 referencing an email that (b)(7)(C) sent out to you
4 enclosing an article.

5 (Exhibit No. 31 was marked for
6 identification.)

7 THE WITNESS: I recall this.

8 BY MR. KOTZ:

9 Q Do you recall I guess a concern that information
10 about the settlement was getting leaked out at this point in
11 time?

12 A Yeah. You know, always a concern.

13 Q And you were aware at that time that the actual
14 Commission vote, with respect to the Goldman action
15 recommendation had leaked out as well. Right?

16 A From the approval of the filing. Yes. By I
17 think -- I don't know. It might have been Kara Scannell as
18 well.

19 Q Right. And so in this email Stephen Cohen says to
20 Myron Marlin, "Guess they got first crack at framing the
21 story." Was there a concern that at least this article, Kara
22 Scannell's article on July 15th, came from Goldman in an
23 effort for Goldman to kind of spin the settlement as
24 something favorable to them or maybe more favorable to them?

25 A I saw it as a Goldman story, and I called (b)(7)(C)

1 about it actually. I don't remember why I saw it -- I think
2 it was because -- again, I'd have to read it. I don't know
3 if there's something in here or just based on the substance,
4 but that was my assumption.

5 Q And what did you tell (b)(7)(C)

6 A It also -- you know, it's not quite clear, because
7 it talks about having settlement discussions, which have been
8 going on since May. Right? So you can't really tell how
9 timely her information was.

10 Q But what was your conversation with (b)(7)(C) like?

11 A I called him, and I was unhappy with this. And I
12 recall -- I think there was a press report about the
13 conversation, oddly enough.

14 Q Right.

15 A But what -- and I remember the press said something
16 like I was upset that they were getting the better of the
17 deal or something. That really wasn't the issue. What I
18 talked -- what I told him about is -- let me back up a
19 little. A critical point in the settlement was that the \$550
20 million that was going to be paid was only to settle Abacus.
21 That was it.

22 Q Right.

23 A That deal, \$550 million. We were very clear that
24 these other CDO investigations, even if we resolved them at
25 the same time, were not part of the settlement. This was not

1 a \$550 million settlement for 11 cases.

2 Q Right.

3 A It was \$550 million for one settlement, and we may
4 tell Goldman that we are concluding our investigations in
5 these other matters without recommending charges, but that
6 doesn't mean we're settling them. And that was an important
7 point for us, because we didn't want them out there saying,
8 you know, they settled 12 CDO investigations for an average
9 of \$30 million each, and, you know, didn't they get a great
10 deal. So the way we structured the settlement was everything
11 spoke only to Abacus.

12 And when we communicated to them that we're
13 discontinuing these other ones, we made it clear that, you
14 know, those were other ones that didn't include Abacus, and
15 they were very separate. The article -- I don't remember
16 where in here -- combining a settlement of Abacus with the
17 resolution of related probes -- right?-- all in one
18 settlement. I was worried that Goldman was doing exactly
19 what it is that we had told them we didn't want to happen,
20 that they were going to pitch this as settling 13 CDO cases.
21 And so that's when I called and in somewhat stark terms that
22 I thought it was inappropriate.

23 Q And so were you concerned generally that further
24 details about the actual settlement would leak out, before
25 the SEC had an opportunity to announce it?

1 A That's always -- I mean obviously they had some
2 source of information, so -- and obviously, you know, Goldman
3 knew, Sullivan and Cromwell knew. You know, the category of
4 people who know about cases is always broad. This was even
5 broader.

6 Q So was there a particular concern in this case,
7 given that Goldman could try to spin the settlement in such a
8 way that makes them look better, when that wasn't what you
9 had agreed to?

10 A Yeah. Although look better -- I mean part of it is
11 just being -- it's really just being accurate. I mean, you
12 know, it's really about accuracy.

13 MR. KOTZ: And so if you recall, the Commission --
14 and I can show you this email. Why don't I just show you the
15 email? Exhibit 32, from John Nester to you and other folks,
16 7/15/2010, 9:55 a.m.

17 (Exhibit No. 32 was marked for
18 identification.)

19 BY MR. KOTZ:

20 Q So this is another timeline that was put together
21 for Thursday, July 15, 2010.

22 A Yeah. I see it.

23 Q And so there was a decision made at this time, that
24 even though the settlement, the Goldman settlement, would be
25 approved by the Commission relatively late in the day, that

1 the Goldman case would be filed and announced that day,
2 Thursday, July 15th in the afternoon, the late afternoon.

3 A Yes.

4 Q Okay. Were you participating in that decision?

5 A Yes. I think we had a meeting amongst a number of
6 folks to talk about, maybe among other topics, but also when,
7 with the press people and myself.

8 Q Okay. And was one of the reasons that the decision
9 was made to file and issue the settlement that evening,
10 almost immediately after the SEC Commission had approved it,
11 was concern about, you know, this article or other leaks if
12 you waited until the next day?

13 A That's certainly one of the -- I think that's one
14 of the factors.

15 Q What were the other factors?

16 A I think -- I think it's just there's the
17 generalized concern about wanting to do it as soon as
18 possible. I don't recall whether or not -- this is a little
19 speculation, but if we decided we wanted to do it after the
20 market closed, then if you didn't do it on Thursday that
21 means you'd be doing it Friday at 5:00. That's probably not
22 an opportune time, just for people to -- I don't remember
23 whether or not my schedule had anything to do with -- that's
24 the best of my recollection.

25 Q Okay. You're saying not an opportune time vis a

1 vis the press to have something released on Friday --

2 A Well, Friday. Just Friday at 5:00 or later just
3 who's around, end of the week, that kind of thing. I'd have
4 to go back and look at my schedule to see if there were other
5 things going on that kind of resulted in this happening.

6 Q Could it sometimes put the SEC in a difficult
7 position if there's a settlement that has been reached, the
8 Commission has approved it, but they haven't filed it,
9 somebody else leaks information out about it, and the SEC not
10 only doesn't get an opportunity to sort of frame the story,
11 but they can't even comment on it, because they haven't yet
12 filed it, so the information is still potentially non-public?

13

14 A That sounds -- I mean that sounds like -- that
15 sounds accurate. I don't know that anyone expressed that
16 view, but it's accurate. I mean for me -- the main thing for
17 me is accuracy and, you know, it's also accuracy for the
18 people we regulate. Right? It's the financial institutions
19 and the brokers and the investment advisors. You know, it is
20 less -- it's less -- when you think about molding the
21 message, you know, that has a market aspect to it that's not
22 really -- for me, it's more we have a responsibility to a
23 regulated community of people who look at our decisions very
24 closely. And the accuracy to them is what's kind of
25 critical.

1 Q But isn't it also fair to say that there's a
2 deterrent effect when the SEC enforcement division announces
3 something, gets press coverage about an action that they
4 brought? I mean isn't there a benefit just generally
5 deterrence-wise?

6 A Sure. Sure. And the public taxpayers view it as,
7 you know, the SEC -- their tax dollars are being used for the
8 purposes for which they were intended.

9 Q Right. All right. Now, if you look at this
10 schedule on Exhibit 32, you'll see that market close at 4:00
11 p.m., copies to court clerk, 4:15, so press release issued
12 4:15 to 4:30. So the decision was made to actually file the
13 settlement and issue the press release after the market
14 closed. But the press advisory was before the market closed.
15 Do you see that?

16 A I see that.

17 Q Okay. And were you aware that because of the press
18 advisory and because there had been stories about the Goldman
19 settlement that there was actually a fluctuation in Goldman's
20 stock that occurred between 3:45 and 4:00, because I guess
21 people figured out that the press advisory from the SEC was
22 going to announce the Goldman settlement.

23 A That I don't recall.

24 Q I mean if that was the case, would that be a reason
25 to say delay even the press advisory until after 4:00, if you

1 Q In all the conversations you had with either
2 Congressman or Congressional staff members regarding
3 financial regulatory reform, did anyone bring up or was there
4 any discussion about the Goldman Sachs investigation prior to
5 it being filed?

6 A No.

7 Q Would you say that generally the division of
8 enforcement was in favor of financial regulatory reform going
9 forward? I mean there may have been things in it that you
10 liked more than others, but do you think it was division of
11 enforcement's view that financial regulatory reform would be
12 a good thing? I mean the Chairman is on record, but I'm
13 asking more about enforcement.

14 A You know, I'm a little reluctant to articulate a
15 view for all of enforcement. I don't think -- I think most
16 people probably didn't know a whole lot about the particular
17 stuff that was in there, mostly because the enforcement stuff
18 was not the headline stuff. I mean the biggest things for us
19 were -- I mean cell funding was important in the enforcement
20 division for the same reason it was important to everybody;
21 Grand Jury secrecy, which fell away, was important to us;
22 whistleblower was important to us. And then the rest of it
23 was kind of a dog's breakfast of particular tweaks and fixing
24 legislative oversight. So, you know, I would be reluctant to
25 try and articulate a division-wide view.

1 Q What about your view?

2 A My view was that cell funding was good; Grand Jury
3 secrecy -- was good. I didn't pay attention to a lot of the
4 rest of it, the esoterica. And the other things that I
5 thought were good for us was hedge fund registration and
6 derivatives clearing, just because it provided for more audit
7 trail and more trading information to aid our investigations.
8 But the big headline stuff, you know, college regulators, and
9 liquidation plants, credit agency reform, all the rule-making
10 stuff, which is the bulk of it, didn't -- was kind of
11 agnostic on it.

12 Q Did you think, kind of all things being equal, that
13 it would be better than not for the enforcement division if
14 financial regulatory reform went through?

15 A Again, I don't mean to be non-responsive, but I
16 thought about more in terms of the particular things rather
17 than the overall package. I guess your question is, if you
18 had no choice -- to get the things you wanted, but it had to
19 be part of everything else, you know, would you do it. I
20 don't know. I don't think I really had a view.

21 Q Were there times during the course of the financial
22 regulatory reform legislation passing through Congress where
23 there were sort of ebbs and flow? Sometimes it looked more
24 likely it was going to pass; other times it looked less
25 likely. Do you recall that generally, or were you not --

1 A Honestly I didn't track it that closely. My focus
2 was on the individual provisions, and I relied on the
3 legislative affairs people to call me and say, you know, X is
4 in trouble, X being, you know -- can you help.

5 Q So you recall that individual provisions in the
6 financial regulatory reform legislation that were important
7 to the enforcement division sort of had an ebb and flow,
8 sometimes it looked more likely those provisions would get it
9 and sometimes less likely?

10 A Well, more just when -- I think it was driven by
11 Congressional staff questions, so I had a phone conversation
12 with folks on whistleblower. I think I had a phone
13 conversation on Grand Jury secrecy with staff. I went and
14 saw (b)(7)(C) about an 180 day deadline that the wanted to
15 impose, that kind of thing.

16 Q Okay. In any conversation, either with folks in
17 Congress or internally regarding financial regulatory reform
18 legislation was it ever raised it would be good if the
19 enforcement division would bring a big case, because that
20 would really provide a push? Perhaps a big case related to
21 the financial crisis, that would provide a push for the
22 things you wanted in financial regulatory reform.

23 A Never.

24 Q Okay. Now, some speculate that when the SEC did
25 file its action against Goldman Sachs in April 2010 that that

1 think the President was going to give a press conference
2 announcing whatever had happened, the vote or whatever. And
3 we had a brief meeting to just decide, while we should
4 probably wait until the President finishes his press
5 conference before we announce our case. That was the extent
6 of my awareness.

7 Q Was there any discussion at that point about
8 pushing the SEC filing and announcement of Goldman Sachs's
9 settlement to Friday, given perhaps concern about the
10 perception that might result from the previous complaint
11 Congressman Issa made?

12 A Maybe. But it was sort of quickly dismissed and
13 rejected kind of. Maybe it was even -- I only have a hazy
14 recollection. It was maybe more in the line of, this is
15 going to cause more people to just, you know, raise these
16 issues, even though it was obviously -- the timing had
17 nothing to do with each other.

18 Q So you're saying --

19 A But we went ahead.

20 Q -- it would raise more issues if you actually
21 decided to wait because of financial regulatory reform
22 legislation?

23 A And it's just inappropriate, equally inappropriate
24 to do that as it would have been to try and time things.

25 Q Okay. Was there any consideration given just

1 generally -- it's late in the day already on Thursday. You
2 know, the press might be saturated with financial regulatory
3 reform being issued. Maybe it might make sense to wait to
4 Friday to announce the Goldman settlement?

5 A That I don't -- I don't remember that so much. I
6 remember we also ended up getting delayed because of some
7 technical problem with the like web -- whatever web feed we
8 have, that there was a technological problem, which also
9 contributed to a little bit of the delay.

10 Q But was there any connection at all between the
11 fact that the SEC filed and announced its Goldman case on
12 Thursday, July 15, 2010 and that was the day that the Senate
13 voted on financial regulatory reform?

14 A No.

15 Q All right. I'm going to ask you now a series of
16 questions. Do you have any reason to believe that the SEC's
17 action against Goldman Sachs, or the timing of that action,
18 was related or to advance financial regulatory reform?

19 A No reason whatsoever.

20 Q Are you aware of any information indicating that
21 the SEC's action against Goldman Sachs, or the timing of that
22 action, was related or to advance financial regulatory reform
23 legislation?

24 A No.

25 Q Are you aware of any information indicating that

1 the SEC coordinated its action against Goldman Sachs with the
2 Executive Office of the President, the White House, or any of
3 its employees?

4 A No.

5 Q Did you have any communications at all with the
6 White House about financial regulatory reform?

7 A No.

8 Q Are you aware of any information indicating that
9 anyone at the SEC shared any information -- I guess I don't
10 need to ask this, but I will anyway. Are you aware of any
11 information indicating that anyone at the SEC shared any
12 information concerning its Goldman Sachs investigation with
13 the Executive Office of the President, the White House, or
14 any of its employees, prior to the complaint being filed?

15 A No.

16 Q Are you aware of any information indicating that
17 the SEC coordinated its action against Goldman Sachs with any
18 members of Congress or any Congressional employees?

19 A No.

20 Q Are you aware of any information indicating that
21 anyone at the SEC shared any information concerning its
22 Goldman Sachs investigation with any members of Congress or
23 Congressional employees, prior to the complaint being filed?

24 A No.

25 Q Are you aware of any information indicating that

1 the SEC coordinated it's action against Goldman Sachs --

2 A Sorry. Prior to it being filed?

3 Q Right.

4 A Yeah. Because we gave them a briefing after it was
5 filed.

6 Q Right. I'm asking prior to filing.

7 A Yeah.

8 Q The answer prior to filing is no?

9 A Is no.

10 Q Okay. Are you aware of any information indicating
11 that the SEC coordinated its action against Goldman Sachs
12 with the Democratic National Committee, the Democratic Senate
13 Campaign Committee, the Democratic Congressional Campaign
14 Committee, or any of their employees?

15 A No.

16 Q Are you aware of any information indicating that
17 anyone at the SEC shared any information concerning its
18 Goldman Sachs investigation with the Democratic National
19 Committee, the Democratic Senate Campaign Committee, the
20 Democratic Congressional Campaign Committee, or any of their
21 employees prior to the complaint being filed?

22 A No.

23 Q Have you ever had any communications while at the
24 SEC with the Democratic National Committee, the Democratic
25 Senate Campaign Committee, or the Democratic Congressional

1 Campaign Committee?

2 A No.

3 Q Are you aware of any information indicating that
4 anyone at the SEC shared any information concerning its
5 Goldman Sachs investigation with the news media or any
6 journalist, prior to the complaint being filed?

7 A No.

8 Q And with respect to the settlement of Goldman
9 Sachs, are you aware of any information indicating that the
10 SEC coordinated the settlement with Goldman Sachs with either
11 the Executive Office of the President, the White House, its
12 employees, members of Congress or Congressional employees, or
13 the Democratic National Committee, Democratic Senate Campaign
14 Committee, Democratic Congressional Campaign Committee or any
15 of their employees?

16 A No.

17 MR. KOTZ: All right. We are going to just take a
18 little break. We're going to go off the record.

19 (Whereupon a brief break was taken.)

20 BY MR. KOTZ:

21 Q All right. Just one more question, just to
22 clarify. (b)(7)(C) or whoever came forward with the New York
23 Stock Exchange and raised an issue after Goldman, the Goldman
24 filing of the action. Do you know if anybody got back to
25 (b)(7)(C) to discuss those issues with him? Did you get back to

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

In the Matter of:)
) File No. OIG-534
OIG-534)



WITNESS: Number 23
PAGES: 1 through 37
PLACE: Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C.
DATE: Friday, August 13, 2010

The above-entitled matter came on for hearing, pursuant
to notice, at 2:03 p.m.

Diversified Reporting Services, Inc.

(202) 467-9200

APPEARANCES:

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Washington, D.C. 20549

(b)(7)(C)

On behalf of the Witness:

SCOTT FRIESTAD, PRO SE

C O N T E N T S

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WITNESS:

Scott Friestad

EXAMINATION

4

EXHIBITS:

DESCRIPTION

IDENTIFIED

1

E-mail chain dated 4/14/2010

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E-mail chain dated 4/18/2010

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E-mail dated 4/19/2010

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SEC Administrative Regulations

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1 about the recommendation being on the calendar?

2 A I don't recall for sure, but it was I believe a
3 reporter from Bloomberg.

4 Q Okay. If I said the name do you think you would
5 remember?

6 A I think -- I know it was one of two people. I
7 don't recall which of them it was.

8 Q Who were the two people?

9 A It was either Josh Gallo or David Shear.

10 Q Okay. And how did you come to learn this
11 information?

12 A The individual called me, and I believe it was that
13 morning, early afternoon, somewhere around that time period.

14 Q And I assume they didn't indicate how they knew
15 this information?

16 A No.

17 Q Did you ask them?

18 A No.

19 Q You would assume that they wouldn't tell you
20 anyway?

21 A Correct.

22 Q Okay. And what was their follow-up? Why were you
23 sending this to Khuzami, Reisner, McKown, Lench, and Muoio?

24 A Because I knew they all were involved with the
25 Goldman case, and I thought it was important to let them know

1 about the issue. To be clear -- I just want to make one
2 thing clear, because this e-mail doesn't reflect it. The
3 person didn't tell me they knew it was Goldman. The way that
4 it was described to me was that there was an interesting or
5 important CDO case on the calendar today. I knew it was
6 Goldman, because I knew what was on the calendar that day,
7 and so I was sort of putting -- trying to put two and two
8 together. But the person who I spoke with didn't refer to it
9 as the Goldman case or anything like that, just so you know.

10 But my point was I was concerned about the fact
11 that anything was known publicly about it, and wanted to make
12 sure that people around here knew that there was something
13 out in the public domain. And I tend to know from experience
14 that when reporters know things they keep fishing and trying
15 to gather more and more details and information, and that, as
16 my e-mail reflects, the longer time lag there is between an
17 enforcement recommendation being approved and it ever
18 becoming public, the greater the risk that there's something
19 that will leak in the meantime. And that was -- I was trying
20 to let people know that there was a risk of that in this
21 situation, because of what I had heard.

22 Q Now, did this reporter try to get information out
23 of you about the case?

24 A Not -- no. And I -- as is typical, I was mainly
25 just listening and not responding with information.

1 A I don't have the manual memorized, so I'm not sure.

2 Q Okay.

3 A I don't think that's a requirement, to my
4 knowledge. I mean I think it's a general practice, you know,
5 in terms of how we deal with people. But I don't think that
6 there's any requirement that we have to do that.

7 Q What is the general practice in the enforcement
8 division, to your understanding?

9 (b)(2),(b)(5)

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23 Q And what would be the purpose of doing that?

24 (b)(2),(b)(5)

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(b)(2),(b)(5)

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9 Q And did you learn that in the Goldman case that
10 that was not the approach that was used?

11 A Eventually I learned that. Yes.

12 Q Okay. Do you know why that was not the approach
13 used?

14 A I don't.

15 Q Okay. And when you say, "No. That's
16 inconceivable," what were you referring to in this e-mail
17 string?

(b)(5)

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1 A They both were going to be planned to be filed on
2 Friday or become public on Friday.

3 Q At what timeframe did you learn that? How much
4 before Friday?

5 A I don't recall. It was probably sometime that
6 week, maybe Wednesday or Thursday of that week. I don't -- I
7 just don't recall for sure. But I mean not a long time in
8 advance, but sometime in advance of Friday.

9 Q And so Joan McKown told you that?

10 A I don't recall for sure, but that's my best guess.

11 Q And do you know how she knew that?

12 A I don't for sure, but I know she -- I believe she
13 was working on the IG report, redaction issues and some other
14 issues with -- working with the general counsel's office on
15 that, I believe. And so in that capacity, I believe had some
16 idea of what the plan was for releasing it from a timing
17 standpoint.

18 Q And was there an indication that that was
19 coordinated on purpose to release both on the same day?

20 A Say that again.

21 Q Did you get the indication that it was -- that
22 there was a reason that the decision was made to release both
23 the Goldman case and the Stanford IG report on the same day?

24 A I don't recall a reason being articulated as to
25 why.

1 Q Do you have an understanding of what the reason
2 might be?

3 A I have a guess.

4 Q What would that be?

5 A That it was perceived that the Stanford report was
6 going to generate negative publicity, and that the Goldman
7 case would result in some positive publicity, and whoever
8 decided made the decision that it made sense to have both
9 become public on the same day.

10 Q And do you know if the decision, with respect to
11 the Goldman case, was delayed -- its release was delayed to
12 coincide with the Stanford IG report, or was the Stanford
13 release delayed to coincide with the Goldman report, or how
14 it worked?

15 A Say that again.

16 Q Well, you want to file two matters on one day. So
17 you could either delay one to make sure or you could delay
18 the other. Do you know, you know, any of the specifics of
19 how it was worked out?

20 A I don't. I wasn't really involved in the decisions
21 on either, other than to observe that both were heading
22 towards becoming public at the same time. And but I don't
23 know -- I mean I'm not aware of someone intentionally, for
24 example, delaying something to hold it up for something else.

25 Q Okay. And you say, "They better be careful. They

1 may get asked for e-mails, etc. from Congress or pursuant to
2 FOIA request." Were there particular e-mails that you had in
3 mind here?

4 A No. I just assumed that -- I assumed it was not
5 coincidental. I assumed there were communications between
6 and among some people within the Commission about the issue
7 of filing both on the same day. And my concern was that
8 people not say things publicly that might be false.

9 Q You made the assumptions, but were you aware
10 specifically of that?

11 A No. No. No. I just -- no. I was not. I was
12 not -- as I -- to my knowledge, part of any or aware of any.
13 I was only aware that there was a plan to have both announced
14 on Friday.

15 Q Did you have any other conversations with anyone
16 else, other than this conversation I think you have with Joan
17 about this issue?

18 A About the issue that's in the e-mail?

19 Q Yeah.

20 A I probably had discussions with other people about
21 the article that I was referencing.

22 Q Okay.

23 A Where a public statement was made that it was
24 coincidental. I believe that was a Financial Times article,
25 if I recall. And I probably mentioned it to other people,

1 heard about that?

2 A I've done it before. Sure.

3 Q You have?

4 A Sure.

5 Q What were the situations in which you did that?

6 A I just did it a couple of weeks ago, when we filed
7 the CitiGroup case.

8 Q How come?

9 A Just to give them a heads up.

10 Q And is it generally the practice of the enforcement
11 to do that in a case where you think there's going to be a
12 significant market impact from the filing?

13 A I didn't know there was going to be a significant
14 market impact. There's usually not a way -- it's hard to
15 predict that or handicap that. It's really more it's news,
16 and it could effect the stock or trading in the stock. And I
17 think it's a -- for a company like that, that's followed as
18 closely as it is for that type of news, it's important to
19 just -- so that they're not caught flat-footed to try to
20 provide that type of notice.

21 Q And so is it your understanding that it is sort of
22 enforcement's practice to do that in cases where there's at
23 least a potential impact? Or is that just your practice?

24 A I'm not sure if it's a division-wide practice.
25 It's something that I've done many times before. I don't

1 know that I've done it in every case that we have involving a
2 public company. But if it's something that I think is going
3 to get a fair amount of attention and scrutiny, that tends to
4 be the types of factors I would consider in deciding to make
5 that type of a call.

6 Q Do you think that it would have been appropriate to
7 give the New York Stock Exchange a heads up in the case of
8 the Goldman lawsuit? Would that have been a situation where
9 you might have done that?

10 A I don't think anyone foresaw the reaction to the
11 Goldman case that actually occurred. But I think it was
12 anticipated it would be viewed as a significant case, and all
13 things being equal, I think it's the type of case that
14 generally I would have erred on the side of providing notice.

15 Q Anyone else you give notice to, other than the New
16 York Stock Exchange?

17 A Sometimes. It depends on the entities. You know,
18 if we're suing -- like with the CitiGroup case, to use that
19 as an example, I think we called the Fed. I think it's one
20 of our practices when we're dealing with a large financial
21 institution to -- we're expected to provide notice to those
22 folks, so that they're aware of the action, impending action.

23 Q Anyone else?

24 A Well, we have different practices. I mean
25 sometimes, for example, if I was filing a case involving a

1 regulatory reform legislation in connection with the Goldman
2 Sachs investigation or in connection with the filing of an
3 action against Goldman Sachs before the case was filed?

4 A Can you say that again?

5 Q Has anyone at the SEC ever mentioned the financial
6 regulatory legislation in connection with the Goldman Sachs
7 investigation or in connection with the filing of an action
8 against Goldman Sachs prior to being it filed?

9 A Not that I'm aware of.

10 Q Do you have any reason to believe that the SEC's
11 action against Goldman Sachs, or the timing of that action,
12 was related to or specifically to advance financial
13 regulatory reform?

14 A Not that I'm aware of.

15 Q Are you aware of any information indicating that
16 the SEC's action against Goldman Sachs, or the timing of that
17 action, was related or to advance financial regulatory
18 reform?

19 A No.

20 Q Are you aware of any information indicating that
21 the SEC coordinated its action against Goldman Sachs with
22 either, the White House, its employees, members of Congress,
23 Congressional employees or Democratic committees?

24 A I'm not aware of anything like that.

25 Q Are you aware of any information indicating that

1 the SEC coordinated the timing of the settlement with Goldman
2 Sachs with the White House, members of Congress,
3 Congressional employees, or Democratic committees?

4 A No.

5 Q Is there anything else related to the issues that
6 we asked you about that you want to add?

7 A I can't think of anything.

8 MR. KOTZ: Okay. All right. Great. So I don't
9 have any further questions. I would ask, to preserve the
10 integrity of the investigation that you not discuss the
11 content of your testimony with anyone.

12 THE WITNESS: Okay.

13 MR. KOTZ: And with that, we're off the record.

14 (Whereupon, at 2:51 p.m., the examination was
15 concluded.)

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

In the Matter of)

) File No. OIG-534

OIG-534)

ORIGINAL

WITNESS: Number 41

PAGES: 1 through 20

PLACE: Securities and Exchange Commission

100 F Street, N.E.

Washington, D.C.

DATE: Tuesday, August 17, 2010

The above-entitled matter came on for hearing, pursuant to notice, at 3:25 p.m.

Diversified Reporting Services, Inc.

(202) 467-9200

1 APPEARANCES:

2

3 On behalf of the Securities and Exchange Commission:

4 DAVID KOTZ, ESQ., Inspector General

5 (b)(7)(C) ESQ.

6 Office of the Inspector General

7 Securities and Exchange Commission

8 100 F Street, N.E.

9 Washington, D.C. 20549

10 (b)(7)(C)

11

12 On behalf of the Witness:

13 LUIS AGUILAR, pro se

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C O N T E N T S

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WITNESS:

Luis Aguilar

EXAMINATION

5

EXHIBITS:

DESCRIPTION

IDENTIFIED

(None)

1 kind of analyze the materials related to the settlement?

2 A I don't recall all the specific reasons why, but I
3 know there was the effort made to give an opportunity to the
4 commissioners to discuss with the attorneys bringing the
5 case, and Rob and Lauren to have more of a Q and A about the
6 case.

7 Q Okay. Was it a relatively short timeframe in which
8 you had an opportunity to review the information and prepare
9 for the meeting?

10 A Not a seemingly short amount of time; we had --
11 sometimes you actually have documents in your possessions for
12 weeks leading up to a closed meeting. This was more
13 truncated than that.

14 Q Okay. But it was not totally unusual that there
15 would be a truncated time period?

16 A No.

17 MR. KOTZ: Okay .

18 (b)(7)(C) Do you believe that you had an
19 adequate amount of time to review Goldman's settlement offer
20 before voting whether he will accept it or not?

21 THE WITNESS: Yes.

22 BY MR. KOTZ:

23 Q Did you have any understanding as to why the review
24 was truncated, why there was a need to go forward in that
25 swift vein?

1 A To the best of my recollection, Goldman had a
2 scheduled earnings of filing/public statement; and, I
3 believe, there was an opportunity the staff thought to get a
4 settlement done to allow less, you know, grayness in the
5 market.

6 Q All right. You are, I assume, aware of the
7 financial regulatory reform legislation that was recently
8 passed by congress?

9 A Yes.

10 Q Okay. Has anybody at the SEC ever mentioned
11 financial regulatory reform legislation in connection with
12 the Goldman Sachs investigation or in connection with the
13 filing of an action against Goldman Sachs prior to the case
14 being filed?

15 A No.

16 Q Do you have any reason to believe that the SEC's
17 action against Goldman Sachs or the timing of that action was
18 related or specifically to advanced financial regulatory
19 reform?

20 A No.

21 Q Are you aware of any information indicating that
22 the SEC's action against Goldman Sachs or the timing of that
23 action was related to or specifically to advance financial
24 regulatory reform?

25 A No.

1 Q Are you aware of any information indicating that
2 the SEC coordinated its action against Goldman Sachs with the
3 Executive Office of the President, the White House, or any of
4 its employees?

5 A No.

6 Q Are you aware of any information indicating that
7 anyone at the SEC shared any information concerning its
8 Goldman Sachs investigation with the Executive Office of the
9 President, the White House or any of its employees prior to
10 the complaint being filed?

11 A No.

12 Q Are you aware of any information indicating that
13 the SEC coordinated its action against Goldman Sachs with any
14 members of congress or any congressional employees?

15 A No.

16 Q Are you aware of any information indicating that
17 anyone at the SEC shared the information concerning its
18 Goldman Sachs investigation with any members of congress or
19 congressional employees prior to the complaint being filed?

20 A No.

21 Q Are you aware of any information indicating the SEC
22 coordinated its action against Goldman Sachs, the Democratic
23 National Committee, the Democratic Senate Campaign Committee,
24 the Democratic Congressional Campaign Committee, or any of
25 their employees?

1 A No.

2 Q Are you aware of any information indicating to
3 anyone at the SEC shared any information concerning its
4 Goldman Sachs investigation with the Democratic National
5 Committee, the Democratic Senate Campaign Committee, the
6 Democratic Congressional Campaign Committee, or any of their
7 employees prior to the complaint being filed?

8 A No.

9 Q With respect to the settlement that the SEC entered
10 into with Goldman Sachs, are you aware of any information
11 indicating that the SEC coordinated the settlement with
12 Goldman Sachs with the Executive Office of the President, the
13 White House, its employees, members of congress or
14 congressional employees, or the Democratic National
15 Committee, Democratic Senate Campaign Committee, Democratic
16 Congressional Campaign Committee, or any of their employees?

17 A No.

18 Q You were aware that the actual votes that you as
19 one of the commissioners had with respect to both the initial
20 action against Goldman Sachs and the settlement against
21 Goldman Sachs were provided in the newspaper. Were you aware
22 of that?

23 A I read it in the newspapers.

24 Q Okay. All right. Do you have any idea of who
25 might have leaked that information?

1 A No.

2 Q Okay. And you and your staff would not -- didn't
3 participate in any improper leaking?

4 A No. Not to my knowledge.

5 Q Okay. All right. And are you aware of any
6 information indicating that the timing of the settlement with
7 Goldman Sachs was related to the possibility or the concern
8 about leaks in the media?

9 A No.

10 MR. KOTZ: Okay.

11 (b)(7)(C) I don't have any questions.

12 MR. KOTZ: Okay. That's all the questions I have.

13 The only thing I would ask is in order to preserve the
14 integrity of our investigation that you not discuss the
15 content of your testimony with anyone until we finish the
16 investigation.

17 THE WITNESS: Yes, I would do as you instruct.

18 MR. KOTZ: Okay. All right. And with that we're
19 off the record.

20 (Whereupon, at 3:46 p.m., the examination was
21 concluded.)

22 * * * * *

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

In the Matter of:)

) File No. OIG-534

OIG-534)

ORIGINAL

WITNESS: Number 18

PAGES: 1 through 94

PLACE: Securities and Exchange Commission

100 F Street, N.E., Room 2465

Washington, D.C.

DATE: Thursday, August 19, 2010

The above-entitled matter came on for hearing, pursuant
to notice, at 9:29 a.m.

Diversified Reporting Services, Inc.

(202) 467-9200

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2

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5 (b)(7)(C) ESQ.

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10 On behalf of the Witness:

11 KENNETH LENCH, pro se

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C O N T E N T S

1			
2			
3	WITNESS		EXAMINATION
4	Kenneth Lench		4
5			
6	EXHIBITS:	DESCRIPTION	IDENTIFIED
7	1	E-mail, Lench and Muoio	16
8	2	E-mail, Lench and Muoio	20
9	3	E-mail, Scarboro and Muoio	22
10	4	E-mail, Muoio to Lench	25
11	5	E-mail, Lench and Calande	26
12	6	E-mail, Lench, Muoio, Reisner	29
13	7	E-mail, Lench, Muoio, Reisner	30
14	8	E-mail, (b)(7)(C) Reisner, McKown	32
15	9	E-mail, Muoio and (b)(7)(C)	35
16	10	E-mail, Muoio, (b)(7)(C) Lench	37
17	11	E-mail, Muoio, (b)(7)(C) Lench	37
18	12	E-mail, (b)(7)(C) and Lench	42
19	13	E-mail, Marlin, Cohen, Spitler	44
20	14	E-mail, Reisner, Muoio, Marlin	45
21	15	E-mail, Reisner, (b)(7)(C) Khuzami	48
22	16	E-mail: (b)(7)(C) to Lench	49
23	17	E-mail, Cohen and Marlin	51
24	18	SEC Admin and PR Reg and Policies	61
25	19	E-mail, Reisner and Khuzami	66

1 A I -- as I look at the e-mail chain, I think there
2 must have been some kind of discussion about when the precise
3 timing would be.

4 I know my own practice, historically, is not to
5 file cases on Fridays, if possible, but I might be a
6 dinosaur, with the -- you know, where I come from, where you
7 don't want to, because most of the news -- you figure
8 Saturday newspapers are not going to be as widely read. And
9 that -- I can't actually, as I'm -- let me read this one more
10 time --

11 Q Sure.

12 A -- because now my message here saying I can't
13 recall now, but wasn't there a reason we couldn't wait until
14 Monday --

15 Q It says, "Not really."

16 A But Reid, in the prior e-mail to me saying, "Unless
17 people have a different view, our preference is to file our
18 complaint the morning of Friday, 1/29," so he is saying file
19 it 1/29, and I am -- I don't exactly understand why I'm
20 asking that question.

21 Q Well, maybe it's further -- you know, to the extent
22 there would be a debate whether to file it Friday or Monday,
23 if there was some other factor involved, some other reason
24 you couldn't wait until Monday, then the decision would be
25 easy.

1 commissioners who felt that the whole case should be brought
2 at the same time, and there was some discussion, and because
3 of that the matter was pulled from the calendar.

4 Does that coincide with your recollection? What do
5 you recollect about that?

6 A When I -- I recollect that there was some of that.
7 There was also -- and I don't know exactly how it factors
8 into the decision to pull the matter from the calendar. But
9 I believe that there were some additional steps as to the
10 ABACUS victims --

11 Q Right.

12 A -- that Rob and Lorin wanted the team to nail down.

13 And, keep in mind, this was at a very early point
14 for me, where I didn't know the case that well, and I knew
15 Reid and people like (b)(7)(C) and (b)(7)(C) were much
16 close to this. And I think that was a factor, I recall. So
17 maybe this Egol issue, as well as this getting additional
18 hard evidence locking the victims in, that this was a
19 material matter to them.

20 Q Okay. And so, you remember -- in addition to that
21 specific issue, you remember also hearing some feedback from
22 commissioners on this Egol issue?

23 A I don't remember that. I thought this was more
24 enforcement's --

25 Q Okay.

1 A -- issue. But I well may not have been privy to
2 discussions that other people in the division were having
3 with the commissioners.

4 Q Do you --

5 A I --

6 Q Okay. Do you remember anything about the question
7 of whether to file the case now against Goldman and maybe --
8 and then continue to investigate on Egol, or whether the
9 appropriate approach would be to do them all together?

10 A I think there were discussions. And part of that
11 is -- I'm saying that because I can see the e-mail chain you
12 had shown me --

13 Q Right.

14 A -- indicating that that was certainly percolating,
15 and that was -- yes. I -- that was an issue that was being
16 discussed.

17 Q Did you have an opinion on that? Are there pros
18 and cons to either bringing the cases separately or together?

19 A I think I have done it both ways at times, and
20 it's -- so it's sort of a case-by-case decision. So I don't
21 know if, in this case, I sort of formed a strong opinion.

22 And again, I hate to keep going back to it, but I
23 just -- I still had my existing caseload --

24 Q Sure.

25 A -- I had just been appointed to be the head of this

1 unit, and I was figuring out plans. And I don't feel like at
2 that point I maybe was the best person to be making that kind
3 of decision.

4 MR. KOTZ: Okay, great. Let's move on to the next
5 document. This is an e-mail from Reid Muoio to you, February
6 5, 2010, 12:45 p.m., and we're going to mark this as SEC
7 Exhibit No. 4.

8 (Exhibit No. 4 was marked for
9 identification.)

10 (The witness examined the document.)

11 THE WITNESS: I see that.

12 BY MR. KOTZ:

13 Q Do you recall this concern about reporters starting
14 to learn certain information?

15 A I generally remember the -- yes, that there were --
16 there seemed to be some information out there, generally at
17 least, about some of our -- these kind of CDO investigations.

18 Q And what was the concern with the fact that this
19 information was out there?

20 A Well, you never want the -- we conduct our
21 investigations on a non-public basis, and you don't want
22 information about your investigations out in the public, just
23 a generalized concern.

24 Q Why wouldn't you want your information out in the
25 public?

1 A Because you hadn't yet -- a fairness type of a
2 concern. We do our investigations the way we do them
3 because, until we file a case and the Commission approves it
4 and then we file it, we can't say anybody has done anything
5 wrong. And reporting about somebody potentially doing
6 something wrong, maybe they did and maybe they didn't.

7 And then, of course, the other concern -- which
8 could be out there also -- is you most effectively can
9 investigate when there is less information out there about
10 what we're doing.

11 MR. KOTZ: Okay. All right, let me move on to the
12 next document, which we're going to mark as SEC Exhibit No.
13 5. It's an e-mail exchange that starts with an e-mail from
14 you to Pauline Calande, 3/4/2010, 4:37 p.m.

15 (Exhibit No. 5 was marked for
16 identification.)

17 (The witness examined the document.)

18 THE WITNESS: Okay, I see that.

19 BY MR. KOTZ:

20 Q All right. Do you recall that Pauline Calande was
21 detailed over to the Senate Permanent Subcommittee on
22 Investigations?

23 A Yes.

24 Q Okay. And did you have a conversation with her
25 about structured products?

1 A And I think it was tied in with that.

2 Q How was it tied in with that, do you know?

3 A I don't know exactly how it was tied in. I saw --
4 there was -- and we even joked about how there was sort of
5 this military precision to -- and I think there may even be
6 some e-mails, maybe you will get to those -- about when the
7 different filings were going to be made, and when Rob was
8 going to be on some kind of panel, or giving some kind of a
9 speech, and when the press calls were going to be.

10 And I think incorporated in that was the Stanford
11 IG report. And then there may even have been another case or
12 two that was being -- that was occurring that day.

13 Q Did you understand that there was an interest in
14 having the Goldman case go out the same day that the Stanford
15 report went out?

16 A I don't remember anyone telling me that, or saying
17 that to me, but I think that's reasonable to conclude, just
18 based on the timing.

19 Q Why would that be, do you know?

20 A It would be a surmise for me to answer that.

21 Q What would the surmise be?

22 A It -- could we go off the record?

23 MR. KOTZ: Sure.

24 (A brief recess was taken.)

25 BY MR. KOTZ:

1 (Exhibit No. 12 was marked for
2 identification.)

3 MR. KOTZ: Again, it's the same beginning.

4 (The witness examined the document.)

5 THE WITNESS: I see this, yes.

6 BY MR. KOTZ:

7 Q Okay. Do you recall a conversation with

(b)(7)(C)

(b)(7)(C)

8

9 A I don't recall the conversation, but I see I must
10 have had one.

11 Q Well, you said, "We" (b)(7)(C) are you concerned we
12 will lose press by filing Friday? Maybe that's the point,
13 given the litigation risk." What did you mean by that,
14 "that's the point, given the litigation risk?"

15 A What I meant was that this was a tough case that we
16 were going to be filing against Goldman, and clearly a
17 somewhat high-profile matter, although I didn't realize quite
18 how high profile it was going to be until afterwards.

19 And you don't want -- there is a risk when you go
20 out in a very public way, where everyone is paying attention
21 to a case you're filing. If you may ultimately lose that
22 case, then it's an extra bad thing. It's bad enough to lose
23 a case, but if it's a real high profile case, it could make
24 the Agency look ineffective, and it's not good for the
25 enforcement program.

1 6:08 p.m.

2 (Exhibit No. 13 was marked for
3 identification.)

4 MR. KOTZ: You are on the bottom e-mail.

5 (The witness examined the document.)

6 THE WITNESS: Yes.

7 BY MR. KOTZ:

8 Q Do you remember learning that a reporter knew that
9 the recommendation for the Goldman action was on the
10 calendar?

11 A I remember Scott Friestad telling me this.

12 Q Do you remember which reporter it was?

13 A I'm going to think it was Josh Balou from
14 Bloomberg.

15 Q Okay. Do you know if anything was done, as a
16 result? Was there any follow-up?

17 A No, I don't recall any follow-up with that.

18 Q Do you know what the purpose of Scott providing
19 this information -- just a heads up?

20 A Yes, I think it's -- probably if you went through
21 my e-mail there would be times when a reporter would have
22 called me with some piece of information, and you would just
23 want to let some other people know who -- you know, who may
24 be getting those kind of calls.

25 Q So that maybe, you know, the reporter might trick

1 the person into revealing something, or whatever?

2 A I suppose that could factor into it.

3 Q Did you get any calls from reporters?

4 A Before -- about this issue?

5 Q Right, before the case was filed against Goldman.

6 A That they knew would have been on -- I don't
7 remember getting such a call.

8 Q Are you aware of anyone who disclosed non-public
9 information about the Goldman case to any reporters?

10 A I do not.

11 MR. KOTZ: All right. All right, let me know you
12 the next document we're going to mark as SEC Exhibit No. 14,
13 an e-mail exchange that starts with an e-mail from Lorin
14 Reisner to Reid Mucio, Myron Marlin, and you, 4/15/2010, 7:42
15 p.m.

16 (Exhibit No. 14 was marked for
17 identification.)

18 THE WITNESS: Should I read from the beginning of
19 this chain?

20 MR. KOTZ: I don't know that you need to. Maybe I
21 can ask the question first, and then you can decide if you
22 want to --

23 THE WITNESS: How about if I just take a minute,
24 just to --

25 MR. KOTZ: Sure.

1 that it was intended to?

2 A Yes.

3 Q Okay. Do you recall the hiccup having to do with
4 the fact that (b)(7)(C) was filing it in New York, but
5 that they wouldn't let him sign his name?

6 A There was something with the signature.

7 Q Okay.

8 A I can't remember exactly what it was.

9 Q Do you know if the fact that the schedule was
10 altered, did that have any impact on whatever plans were on
11 that day?

12 A I think that there was enough fat built into the
13 schedule that we were able to get the proper complaint and
14 get it filed, such that the schedule generally still worked.

15 Q Were you surprised at how much press coverage there
16 was of the Goldman case on that Friday?

17 A Yes.

18 MR. KOTZ: All right, let me show you the next
19 document. SEC Exhibit No. 16 starts with an e-mail from (b)(7)(C)
20 (b)(7)(C) to you, 4/16/2010, 12:50 p.m.

21 (Exhibit No. 16 was marked for
22 identification.)

23 (The witness examined the document.)

24 THE WITNESS: Okay, I see that.

25 BY MR. KOTZ:

1 meeting and the vote, which she seemed to -- I feel like when
2 she -- by the time she called me, she was saying that she had
3 information that it was a 3-2 vote, and was trying to get
4 some kind of confirmation regarding that, and I was not going
5 to give that to her.

6 Q Were you surprised that she knew it was a 3-2 vote?

7 A Yes.

8 Q Do you have any idea how she got that information?

9 A No idea.

10 Q Do you remember her also saying something about one
11 of the Republicans being unhappy because Goldman was not
12 given the chance to settle?

13 A I can't remember her saying those words to me, but
14 I know, in sending an e-mail to my bosses, as I did here, if
15 I wrote it here, she said it to me.

16 Q Do you know if that was true, that one of the
17 Republicans was unhappy because Goldman was not given the
18 chance to settle?

19 A I don't remember that being -- there were some of
20 the commissioners who were unhappy with the case. I don't
21 remember that being one of the issues.

22 Q But is it your understanding that, traditionally,
23 in the enforcement division, when the enforcement staff was
24 bringing a case against an entity, you know, there is the
25 Wells process, there could be potential settlement

1 negotiations, you know, in the ordinary course, but that it
2 was sort of traditionally the policy that after the
3 Commission had approved the decision to file an action, a
4 call would be made to the entity, or the entity's lawyer,
5 saying, "The Commission just approved it, we're going
6 forward, you have 48 hours, or X number of hours, to come up
7 with some resolution. But -- just to let you know."

8 A I think that is many people's practice. It
9 historically has been mine, as well.

10 Q What is the reason for that practice?

11 A It's -- well, let me think about it. I mean, one
12 of the reasons is it's a courtesy the other side -- well, I
13 guess in a litigated matter maybe it's different. I'm
14 thinking more -- in a settled matter, it's a courtesy.
15 They've submitted a settlement offer, they know that it's
16 being submitted to the Commission, it's the right thing to
17 do, to let them know, and to give them some sense as to the
18 timing.

19 In a litigated matter, the main reason why you
20 might want to do it is if you think that there can be a
21 settlement at the 11th hour.

22 Q And generally, is it your view that settlement is
23 sort of always preferred, in terms of resources? Obviously,
24 it has to be a settlement that's on good terms and favorable.
25 But, all other things being equal, it's better to settle than

1 to litigate?

2 A I think that is -- from a programmatic standpoint,
3 we need to enter into a certain number -- a significant
4 number of settlements, because you don't want to be
5 litigating everything, assuming that you can achieve the
6 deterrent's goals of the case.

7 Q Okay. So you agree, generally, with that statement
8 I made, that all other things being equal, assuming that
9 there is a good, favorable settlement terms, it's better to
10 settle in a particular case than to litigate? Just
11 generally?

12 A Generally, you always look for opportunities to
13 settle, yes.

14 Q Okay. And is it also the reason for this policy in
15 a litigated case that once the Commission has approved a case
16 going forward, it's at a much more serious level?

17 So, you know, you can always have a situation where
18 a company will try to argue that you don't bring the case at
19 all, and so they may always think, "Well, we're going to
20 convince them not to bring the case." And if you come back
21 to them and say, "The Commission has approved it," at that
22 point it's pretty clear you're going to bring the case. So
23 there is a value in that, do you think?

24 A One thing -- you did say something about -- you
25 referred to policy.

1 Q Practice.

2 A And --

3 Q Your practice.

4 A Yes --

5 Q I am asking about -- you know, why is it your
6 practice?

7 A I think that there are, and I have had matters
8 where the people you're considering bringing the case
9 against, the recommendation, they want to push every
10 available -- pursue every available avenue to get the case
11 totally not authorized. So they don't want to give any hint
12 that there is any weakness on their -- at that point.

13 But after the Commission authorizes the case, there
14 is sometimes an opportunity, even with somebody who has told
15 you no, that it could happen. And --

16 Q When you say, "it could happen," you mean settle?

17 A Yes.

18 Q Are you aware of whether there was a specific
19 decision in the Goldman ABACUS case not to give that kind of
20 heads-up that we talked about after the Commission approved
21 the recommendation to go forward?

22 A There -- I will say, generally, yes. There was --
23 although it's an issue that I discussed.

24 Q Okay. Tell me about the discussions.

25 A I think I was having discussions with Reid Muoio

1 about whether to give the company Goldman a heads up that we
2 were authorized, and that we were filing prior to filing the
3 action.

4 Q What was that -- what happened in that discussion?

5 A I feel like I was a proponent of giving that last
6 heads-up, because it had been my practice -- and I had had a
7 recent fairly high-profile case where something similar had
8 happened, where we thought we were most likely going to have
9 to litigate a significant portion of the case. And, after we
10 got authority from the Commission, we went back to the people
11 who we were authorized against, and we ended up with --
12 settling the entire case.

13 So, that was a recent experience I had, and I
14 thought here it was, again, extremely unlikely that there
15 would be any settlement, because there had been sort of no --
16 usually you get some kind of a telegraph of that, and I don't
17 remember anything like that happening from Goldman. But I do
18 think, after you get authority, and they know it's going to
19 be filed, that sometimes that can change a party's thinking.

20 Q And so what did Reid say?

21 A I think Reid was generally not in favor of a --
22 giving a heads-up here.

23 Q How come?

24 A I think that the general concern -- we had concerns
25 with leaks, was one. And the other was I think the concern

1 with some significant delay, because -- I think.

2 As -- I know I'm testifying under oath, and I want
3 to make sure I get this right, because I can't remember if he
4 said this. But when you give that last heads up, there is a
5 chance the other side, to buy time, will start to talk about
6 a potential settlement, and it may not end up going anywhere,
7 but still you could be weeks, if not longer down the road,
8 with your case still not filed.

9 And so, I think sort of this combination of leaks
10 and -- and I guess factored into what Reid and I were
11 discussing was the fact that there hadn't really been an
12 overture. The case I had referred to that I had worked on
13 while I was still an assistant director -- which was at the
14 very end of 2009 -- there were some, albeit small, signals
15 that, you know, give them another chance, if the Commission
16 approved it, and I don't think -- I don't remember anything
17 like that coming from Goldman here.

18 In fact, I think in that other case they had gone
19 out of their way to communicate something that made us --
20 without saying explicitly, "We want to talk settlement," but
21 saying something about having another conversation.

22 Q And so you had this conversation with Reid, and
23 then what happened, do you know?

24 A We -- ultimately, I think Reid and I were of
25 different minds on the issue. I certainly didn't want to

1 give a significant lead time to Goldman, and I think we
2 discussed whether to give it to -- give a heads up to
3 Goldman's counsel late the day before we were going to file,
4 or even the morning of the filing. I think Reid was not in
5 favor of giving any kind of a heads up.

6 And at some point we did talk to Lorin Reisner
7 about this issue in a very -- I feel like it was a lot of
8 running around, a lot of moving parts, and -- but I wanted to
9 at least have Lorin think about the issue. And out of that,
10 I think the decision was made just to give it to them sort of
11 simultaneously with filing, give the heads up.

12 Q Did Lorin give any reason why that decision was
13 made?

14 A I don't remember him saying anything. I think
15 probably was considering the same factors that Reid and I had
16 discussed.

17 Q And so, when the instruction came down from Lorin
18 Reisner, was -- you say "simultaneous." Was it clear whether
19 Reid should make the call right before the SEC filed, or
20 right after the SEC filed?

21 A I feel like the decision was that we would make
22 the -- we would be filed at the point when we let Goldman
23 know. I don't want to say absolutely, because the
24 instructions maybe were a bit vague as to exactly when we
25 were going to notify counsel for Goldman of this. I know it

1 was going to be around the time.

2 But I -- my impression coming out of what we were
3 going to do was that we weren't going to be giving Goldman a
4 chance to put the brakes on filing. That was my impression
5 of what came out of our conversation with Lorin.

6 Q But if Goldman had been called, say, a minute
7 before the case was filed, Goldman still wouldn't be able to
8 stop the filing, but at least they would have heard about it
9 from the SEC, rather than from the press.

10 A Well, that's true. And so, that's what I'm a bit
11 vague on, exactly when we were going to be making the call.
12 I feel like, though, we were not going to be waiting for
13 Goldman to decide that this was going -- that they wanted to
14 pursue a settlement.

15 BY (b)(7)(C)

16 Q You had mentioned in your discussion with Reid
17 Muoio on this issue that one of the reasons that Reid gave
18 was concern regarding leaks. Could you explain what you
19 understood that concern to be?

20 A The -- we thought that Goldman is a pretty
21 sophisticated player. They have -- they're good at the
22 public relations game, and that they might -- they would not
23 be the first company to do this. If you know that something
24 is coming from the SEC, you can maybe take certain actions to
25 sort of -- to precondition the reporters about the case, and

1 maybe the coverage would not be as favorable, from the SEC's
2 standpoint.

3 Q And this may seem like an obvious question, but --
4 and why is that a concern, or of relevance to the SEC,
5 whether or not Goldman Sachs would have an opportunity to
6 sort of shape the story ahead of time?

7 A Here is Ken Lench speaking on, you know, my
8 feelings about these issues. We are a relatively small group
9 of attorneys conducting these investigations over a massive
10 market, and that we need, when we bring an enforcement
11 action, for there to be this general aura of deterrence
12 regarding our actions, because there is no way we're going to
13 identify all the violations occurring out there. And even if
14 we could have a lead into all of them, we wouldn't be able to
15 pursue every one of those investigations.

16 So, we have to make the ones that we do pursue and
17 then decide to file count. And I think that public message
18 is an important part of what the Commission does, and I think
19 that's why you see press releases with quotes from Rob
20 Khuzami, or sometimes the chairman, or others.

21 Q Just one other. You mentioned another recent case
22 you had been involved with a settlement after the Commission
23 had approved. What's the matter with that?

24 A That was a case against the accounting firm of
25 Ernst & Young, and there were six individual partners at E&Y.

1 And also, it's often the case that we get sort of
2 locked in to more of a position after the Commission has
3 authorized our action.

4 Q Right. But do you think in this case, in the case
5 of the Goldman ABACUS action, given that Goldman came in
6 almost immediately after the SEC filed its case with
7 settlement overtures, that by Monday, April 19th, were
8 already in the nature of specific terms, that perhaps
9 Goldman, in this case, would have made some of these same
10 settlement overtures, had that heads-up been given, and the
11 case could potentially have been settled before filing of an
12 action?

13 A I -- it's a hard question for me to answer. I can
14 see the timing as well as you, and it certainly raises the
15 possibility that something may have been done. But it --
16 well, I will leave it at that.

17 Q But it is clear that, as soon as Goldman became
18 aware that the SEC had filed its action, very shortly
19 thereafter, they came forward with settlement discussions.

20 A Yes, and the reason I'm hesitating about answering
21 that question is I know I didn't read -- because I had
22 conversations in advance about press coverage, didn't
23 anticipate this level of press coverage for this case. It
24 caught me by surprise.

25 I knew it would be press-worthy. No idea it would

1 be as big a story as it became. And it could be Goldman saw
2 this press coverage, and it changed their thinking. Maybe
3 before we filed the action they may have been thinking more
4 the way I was thinking: a significant story, but not like
5 the story of, you know, the -- maybe the most covered story
6 ever in the SEC history. So -

7 Q Okay.

8 A I just don't know.

9 Q Okay. Let me ask you this question. Do you know
10 whether you were involved in the decision to file the
11 complaint against Goldman Sachs during trading hours?

12 A Well, I don't -- I wasn't, Because, as I laid out
13 the sequence of events when the timing -

14 Q Right.

15 A -- was sort of set, but I know that I learned
16 afterwards that was an issue. It's not an issue -- like,
17 even if we had filed that Thursday, I think it probably would
18 have been during the trading day. That is our practice. I
19 now am more sensitive to that issue, because I do know some
20 of the discussions afterwards about filing in the middle of
21 the trading day.

22 Q Right. Were there -- was there any consideration
23 that you're aware of prior to the filing of the action to
24 file this case against Goldman not during trading hours?

25 A I have to say I don't think that was an issue on

1 our radar screen, and we didn't discuss it.

2 Q Okay. But after the case was filed, and knowing
3 the impact that it had, not only on Goldman stock, but on the
4 market overall, was there discussion about whether it was,
5 kind of with hindsight, wise to file the action against
6 Goldman Sachs in the middle of the trading day?

7 A What I recall about that (b)(7)(C)
8 (b)(7)(C) in the office of compliance,
9 inspections, and examinations, called me and raised this
10 issue, and sensitized me to the issue, because I have been
11 in -- doing enforcement a long time, and it hadn't been on my
12 radar screen at all.

13 Q What did (b)(7)(C) say?

14 A Essentially, I think he wanted consideration to be
15 given in high profile market-moving types of cases,
16 potentially to file it outside of trading hours because of
17 the impact it had on the market that day.

18 Q And is it in the interest of the SEC generally to
19 avoid market fluctuations that result as -- as a result of
20 their action?

21 A I may leave that to others. It's -- the Division
22 of Enforcement, we want to get the information out. I guess
23 we have an interest in not doing it in a disruptive fashion,
24 I would say. But you balance that against just -- some of it
25 is the logistics of -- the trading day is a pretty long part

1 of the day.

2 Q Right, right.

3 A And I don't think that there are many cases like
4 this case turned out to be. I don't think, as I've said a
5 few times, I didn't realize beforehand the impact. But I do
6 think, at least for me personally, I will think about this
7 issue in high-profile matters.

8 Q And will you, to the extent you can, avoid filing
9 a -- in a high-profile matter, during trading hours, all
10 other things being equal?

11 A If we can do it consistent with sort of our --
12 achieving our goals of our enforcement action, yes, I would.

13 Q And are you aware that, when it came to the filing
14 of the settlement of the Goldman case, the settlement was
15 filed and announced after the trading date?

16 A Yes, I do. I think we waited right until the
17 market closed.

18 Q And do you recall the conversations about that at
19 that time?

20 A I think it was along the same lines that, based on
21 what we had learned as a result of filing the April 16th
22 action during the trading day, that this was big news, and to
23 do it after hours was less disruptive and made sense.

24 Q Do you recall an issue about informing the New York
25 Stock Exchange in advance of the complaint that was filed

1 A Yes.

2 Q Okay. And so, at the bottom of the e-mail that you
3 sent on Thursday, July 8th, to Lorin Reisner, (b)(7)(C)
4 and (b)(7)(C) you say, "Timing: Agree on final papers by
5 Monday; board approval before Commission considers matter
6 next Thursday."

7 Why were you looking for the Thursday? What was
8 that based on? Was that kind of a regularly scheduled
9 calendar session, or was that a special session set up just
10 for this?

11 A I don't think the -- I think there was going to be
12 a Commission meeting already scheduled. We also knew, based
13 on the leaks about the 3-2 vote the prior time, that this was
14 likely going to be an executive -- I guess I had it in my
15 mind this was going to have to be an executive session item.

16 And the timing, I think we knew by this point that
17 there were two issues that were out there as to why we wanted
18 to have the settlement finalized sort of in this mid-July
19 time frame. One had to do with the -- an earnings call
20 Goldman was going to be making, in which they told us we
21 ought to get it done before, because it was going to be very
22 likely that, based on what they were going to have to put out
23 to comply with their disclosure requirements, that the
24 reporters and the public would be able to glean what our
25 settlement number was. And then also, I know that they had

1 an answer due.

2 I think those were the two issues that were driving
3 getting this done quickly. And that Thursday there was a
4 scheduled Commission meeting, and we knew we could attach our
5 executive session on the back end or front end of that
6 meeting.

7 Q And so, the executive session was related only to
8 Goldman?

9 A There were -- I feel like there may have been
10 another executive session item after ours. But the way they
11 do it is the other executive session item, the people related
12 to that, wait outside -

13 Q Right.

14 A -- while we're in there. I feel like maybe there
15 was a second executive session item.

16 Q And the purpose of that is to have as few people as
17 possible participating in the executive session so that
18 information wouldn't be leaked out?

19 A Correct.

20 Q But, of course, in the end, the 3-2 vote on the
21 Commission's settlement, view of the settlement of Goldman,
22 was also leaked.

23 A It was.

24 Q Do you have any idea who might have leaked that?

25 A I have no idea. I would -- very much would like

1 July 15th?

2 A I remember there were discussions about what the
3 timing would be, whether we could make it logistically happen
4 that same day that the Commission approved, or whether it
5 would have to wait until the next day.

6 Q Other than the logistics, what were the kind of
7 substantive reasons to try to get it filed and announced on
8 Thursday?

9 A To the -- sort of the front and center one is to
10 beat leaks. That -- the more time that went by between the
11 Commission approving it and filing the settlement, the more
12 likely it was going to get out there.

13 Q Were there other considerations?

14 A I think there was that -- certainly that
15 consideration about not filing during the trading day. I
16 know -- but I think logistics was one of the real issues
17 about whether we were going to be able to get sort of a --
18 some kind of a courtesy copy to the judge and the more --
19 Lorin Reisner and the litigator types thought that there was
20 some benefit to Judge Jones not just reading about it, giving
21 her some, you know, limited advance notice of this.

22 I can't remember any substantive reasons, though,
23 beyond what I have just described.

24 Q And so, is it fair to say that once it was clear
25 the logistics could work, the decision was made to go forward

1 remember, but I think it may have been Rob, but it --
2 Khuzami -- but I think it was almost a consensus. I feel
3 like there were a lot of people in this conversation, and I
4 know all the press people -- the Myron Marlins, the (b)(7)(C)
5 (b)(7)(C) John Nester types -- saying, "You've got to go
6 Thursday." Thursday was the better time, assuming you could
7 get it logistically done.

8 And once we walked through the fact that we could
9 do this logistically, based on when the Commission would
10 approve us, give us approval, assuming they did, I think it
11 became just clear to everybody that that was the better. But
12 I think Rob was involved in that, since he's the director. I
13 think he would decide.

14 Q Looking at this schedule, do you recall that there
15 was a specific decision to file and announce the Goldman
16 Sachs settlement after the market close, so as not to cause
17 disruption?

18 A I think that was a consideration.

19 Q Now, were you aware that the press advisory, which
20 was sent out before the market close, which was just to
21 notify the media, I guess, that there is going to be an
22 announcement, that because of all the speculation about the
23 Goldman settlement in the paper, the press advisory actually
24 caused Goldman stock to be affected? Were you aware of that?

25 A I don't think I knew that.

1 Q Was there any consideration -- was there any
2 discussion about that fact, that here you are, on Thursday,
3 July 15th, there had been a complaint from Representative
4 Issa, and now you're filing your Goldman settlement the same
5 day that the financial regulatory reform is finally, after
6 months and months, going to be passed?

7 A I don't remember any discussions along those lines.

8 Q Okay. Did you ever have any conversations with
9 congressional Members or congressional staff regarding
10 financial regulatory reform?

11 A No. I don't think I did. I know I was involved in
12 some Hill briefings. It was a congressman from Massachusetts
13 who was interested in the new unit. And I went to the Hill.
14 I think Reid Muoio was there. Lorin Reisner well may have
15 been there, too. I can't remember his name, the
16 congressman's name. And he wanted to hear about our unit and
17 some of our plans.

18 I wouldn't swear that the -- that somehow that
19 issue didn't in some way come up; it certainly wasn't a focus
20 of that conversation. Other than that, I think I
21 participated in Hill briefings regarding the Goldman case,
22 but I don't remember financial reform -

23 Q Now, the Hill briefings regarding the Goldman case
24 were after the SEC filed its action?

25 A Yes.

1 Q Okay. And in any other conversations you had with
2 congressmen or staffers of Congress, did you ever discuss the
3 Goldman ABACUS case?

4 A Could you repeat that one more time?

5 Q In any conversations you had with particular
6 congressmen in Massachusetts, or any other congressmen, or
7 any other senator, or any staffers from Congress, did you
8 ever discuss the Goldman Sachs investigation prior to Goldman
9 filing its lawsuit?

10 A Prior to us filing the Goldman lawsuit? No, I
11 don't think we -- I don't think I or anyone gave a heads up
12 that we were -- to Congress regarding that. I wasn't party
13 to it.

14 Q Has anybody at the SEC ever mentioned the financial
15 regulatory reform legislation in connection with the Goldman
16 Sachs investigation, or in connection with the filing of an
17 action against Goldman Sachs prior to the action being filed?

18 A Not to my knowledge.

19 Q Do you have any reason to believe that the SEC's
20 action against Goldman Sachs, or the timing of the action,
21 was related or specifically to advance financial regulatory
22 reform legislation?

23 A I do not.

24 Q Are you aware of any information indicating that
25 the SEC's action against Goldman Sachs, or the timing of that

1 action, was related or specifically to advance financial
2 regulatory reform?

3 A No.

4 Q Are you aware of any information indicating that
5 the SEC coordinated its action against Goldman Sachs with the
6 Executive Office of the President, the White House, or any of
7 its employees?

8 A I'm not aware of such a thing.

9 Q Are you aware of any information indicating that
10 anyone at the SEC shared any information concerning its
11 Goldman Sachs investigation with the Executive Office of the
12 President, the White House, or any of its employees, prior to
13 the complaint being filed?

14 A I am aware of no such information.

15 Q Are you aware of any information indicating that
16 the SEC coordinated its action against Goldman Sachs with any
17 Members of Congress or any congressional employees?

18 A I do not.

19 Q Are you aware of any information indicating that
20 anyone at the SEC shared any information concerning its
21 Goldman Sachs investigation with any Members of Congress or
22 congressional employees prior to the complaint being filed?

23 A No.

24 Q Are you aware of any information indicating the SEC
25 coordinated its action against Goldman Sachs with the

1 Democratic National Committee, the Democratic Senate Campaign
2 Committee, the Democratic Congressional Campaign Committee,
3 or any of their employees?

4 A No.

5 Q Are you aware of any information indicating that
6 anyone at the SEC shared any information concerning its
7 Goldman Sachs investigation with the Democratic National
8 Committee, Democratic Senate Campaign Committee, the
9 Democratic Congressional Campaign Committee, or any of their
10 employees prior to the complaint being filed?

11 A No.

12 Q Are you aware of any information indicating that
13 anyone at the SEC shared any information concerning its
14 Goldman Sachs investigation with the U.S. Department of
15 Treasury, the Federal Reserve, or any of their employees
16 prior to the complaint being filed?

17 A No.

18 Q Now, with respect to the settlement that the SEC
19 entered into with Goldman, are you aware of any information
20 indicating that the SEC coordinated the settlement with
21 Goldman Sachs with the Executive Office of the President, the
22 White House, its employees, with Members of Congress, or
23 congressional employees, or with the Democratic National
24 Committee, Democratic Senate Campaign Committee, the
25 Democratic Congressional Campaign Committee, or any of their

1 employees?

2 A No.

3 Q And are you aware of any information indicating
4 that anyone at the SEC shared any information concerning the
5 Goldman Sachs settlement with the Executive Office of the
6 President, the White House, any of its employees, Members of
7 Congress or congressional employees, or the Democratic
8 National Committee, Democratic Senate Campaign Committee, the
9 Democratic Congressional Campaign Committee, or any of their
10 employees?

11 A No.

12 Q And are you aware specifically of any information
13 indicating that anyone at the SEC shared any information
14 concerning the Goldman Sachs investigation or the Goldman
15 Sachs settlement with the news media or any journalists prior
16 to either the complaint being filed or the settlement being
17 filed?

18 A No.

19 MR. KOTZ: All right. We're going to go off the
20 record.

21 (A brief recess was taken.)

22 MR. KOTZ: All right, back on the record.

23 THE WITNESS: Okay.

24 MR. KOTZ: We don't have any more questions. The
25 one thing I would ask, in order to preserve the integrity of

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

In the Matter of:)
) File No. OIG-534
OIG-534)

WITNESS: Number 42

ORIGINAL

PAGES: 1 through 20

PLACE: Securities and Exchange Commission
100 F Street, N.E., Room 2465
Washington, D.C.

DATE: Thursday, August 19, 2010

The above-entitled matter came on for hearing, pursuant
to notice, at 2:56 p.m.

Diversified Reporting Services, Inc.

(202) 467-9200.

1 APPEARANCES:

2

3 On behalf of the Securities and Exchange Commission:

4 H. DAVID KOTZ, ESQ., Inspector General

5 (b)(7)(C) ESQ.

6 Securities and Exchange Commission

7 100 F Street, N.E.

8 Washington, D.C. 20549

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10 On behalf of the Witness:

11 TROY ALLAN PAREDES, pro se

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WITNESS

EXAMINATION

Troy Allan Paredes

4

EXHIBITS:

DESCRIPTION

IDENTIFIED

(None)

1 Q Okay. Did you feel that you had sufficient time in
2 that case to review the information and properly prepare for
3 the Commission meeting that occurred in July, with respect to
4 the settlement? Because it was somewhat, I guess, of a
5 rushed process.

6 A I do feel as though I had adequate time.

7 Q Okay. Did you feel like it was a particularly
8 rushed process, do you remember?

9 A I don't feel as though it was -- I don't recall it
10 being particularly rushed.

11 Q Okay. You, I assume, are aware of the financial
12 regulatory reform legislation that was passed by Congress?

13 A Correct.

14 Q Okay. Has anybody at the SEC ever mentioned
15 financial regulatory reform in connection with the Goldman
16 Sachs investigation, or in connection with the filing of an
17 action against Goldman Sachs, prior to the case being filed?

18 A I don't have any recollection of any such mentions.

19 Q Okay. Do you have any reason to believe that the
20 SEC's action against Goldman Sachs, or the timing of that
21 action, was related or specifically to advance financial
22 regulatory reform?

23 A I have no basis for such a belief. Speculation as
24 to lots of other folks and their involvement in a whole range
25 of considerations, but I don't have any factual basis for any

1 belief along those lines.

2 Q Okay. Are you aware of any information indicating
3 that the SEC's action against Goldman Sachs or the timing of
4 the action was related to, or was specifically to advance -

5 A Please repeat -

6 Q Yes, it's similar, but are you aware of any
7 information indicating that the SEC's action against Goldman
8 Sachs, or the timing of the action, may have been related to
9 financial regulatory reform?

10 A I don't have any facts to reach a conclusion that
11 financial reform drove the timing.

12 Q Okay. Are you aware of any information indicating
13 that the SEC coordinated its action against Goldman Sachs
14 with the Executive Office of the President, the White House,
15 or any of its employees?

16 A No, I don't have any information to suggest that
17 there was such a coordination.

18 Q Are you aware of any information that anyone at the
19 SEC shared any information concerning its Goldman Sachs
20 investigation with the Executive Office of the President, the
21 White House, or any of its employees, prior to the complaint
22 being filed?

23 A I don't have any information suggesting there was
24 any such sharing.

25 Q Okay. Are you aware of any information that the

1 SEC coordinated its action against Goldman Sachs with any
2 Members of Congress or any congressional employees?

3 A Again, I don't have any information to suggest any
4 such coordination.

5 Q Are you aware of any information indicating anyone
6 at the SEC shared any information concerning its Goldman
7 Sachs investigation with any Members of Congress or any
8 congressional employees prior to the complaint being filed?

9 A Again, I don't have any information to suggest that
10 sort of sharing.

11 Q Are you aware of any information indicating the SEC
12 coordinated its action against Goldman Sachs with the
13 Democratic National Committee, the Democratic Senate Campaign
14 Committee, the Democratic Congressional Campaign Committee,
15 or any of their employees?

16 A Yes, no information to that effect, either.

17 Q Are you aware of any information indicating that
18 anyone at the SEC shared any information concerning its
19 Goldman Sachs investigation with the Democratic National
20 Committee, Democratic Senate Campaign Committee, the
21 Democratic Congressional Campaign Committee, or any of their
22 employees prior to the complaint being filed?

23 A Again, I don't have any information to that effect,
24 either.

25 Q Okay. You were aware that the Commission votes for

1 both the meeting where the Commission voted to approve the
2 action against Goldman Sachs, and the meeting where the
3 Commission voted to approve the settlement were leaked to the
4 media -- you were aware of that?

5 A I know there were media reports as to what happened
6 at the meetings, or was believed to have happened at the
7 meetings, but I don't have any specific information as to
8 leaks, as such.

9 Q Okay. Do you have any information about who might
10 have leaked that information, assuming it was leaked?

11 A Assuming information were leaked, I don't have any
12 knowledge or information or facts as to who may have been a
13 source.

14 Q And I assume that you didn't provide any non-public
15 information about the Commission votes. And, to your
16 knowledge, no one on your staff did?

17 A Correct.

18 Q All right. With respect to the settlement that the
19 SEC entered into with Goldman, do you have any reason to
20 believe that the SEC settlement against Goldman, or the
21 timing of that action, was related to financial regulatory
22 reform?

23 A I don't have a basis for believing that to be the
24 case.

25 Q And are you aware of any information indicating

1 that the SEC coordinated its settlement with Goldman Sachs
2 with the Executive Office of the President, the White House,
3 its employees, Members of Congress, or congressional
4 employees, or the Democratic National Committee, Democratic
5 Senate Campaign Committee, the Democratic Congressional
6 Campaign Committee, or any of their employees?

7 A I don't have any information suggesting that.

8 Q Okay. And then, are you aware of any information
9 that anyone at the SEC shared any information concerning the
10 Goldman Sachs settlement with the Executive Office of the
11 President, the White House, any of its employees, any Members
12 of Congress or congressional employees, or the Democratic
13 National Committee, Democratic Senate Campaign Committee, the
14 Democratic Congressional Campaign Committee, or any of their
15 employees?

16 A Yes, I don't have any information to that effect,
17 either.

18 Q Okay. Are you aware of any information that the
19 timing of the SEC settlement with Goldman Sachs was triggered
20 by concerns about leaks in the media?

21 A One more time? That question, please?

22 Q There was an allegation that the timing of the SEC
23 settlement with Goldman Sachs was driven by concern about a
24 potential article in the newspaper.

25 A I don't have any information to suggest that was

32

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

In the Matter of:)
) File No. OIG-534
OIG-534)

WITNESS: Number 43

PAGES: 1 through 17

PLACE: Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C.

DATE: Friday, August 27, 2010

 **COPY**

The above-entitled matter came on for hearing, pursuant to notice, at 3:00 p.m.

Diversified Reporting Services, Inc.

(202) 467-9200

1 APPEARANCES:

2
3 On behalf of the Securities and Exchange Commission:

4 H. DAVID KOTZ, ESQ.

5 (b)(7)(C)

ESQ.

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8 100 F Street, N.E.

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C O N T E N T S

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WITNESS:

Elisse B. Walter

EXAMINATION

4

1 Q Okay. We found it was a relatively truncated
2 period of time, but that then necessarily is not so unusual.
3 Do you feel that you had both with the respect to the actual
4 being filed and the settlement, adequate time to understand
5 the issues prior to voting on it?

6 A Absolutely. I was given sufficient time to
7 understand and to discuss.

8 Q Are you aware that details of the specific
9 Commission votes with respect to both the action being
10 brought against Goldman Sachs and the settlement were
11 revealed in the media?

12 A Yes.

13 Q Okay. Do you have any idea who might have leaked
14 that information?

15 A No, I do not.

16 Q And I assume that no one -- that you didn't provide
17 that information and to your knowledge no one in your office
18 did?

19 A That is correct.

20 Q All right. You were aware generally of the
21 financial regulatory reform legislation recently passed by
22 Congress, correct?

23 A Absolutely.

24 Q Okay. Did you have any communications with any
25 congressional officials about financial regulatory reform?

1 A I'm trying to recall whether it ever -- it came up.
2 Well, certainly I did in the sense that I testified before
3 the Senate Agriculture Committee and -- I think it was the
4 Senate, and I had conversations with respect to that. I
5 don't recall any other conversations about the statute
6 directly.

7 Q Did you have any conversations with anyone at the
8 White House about financial regulatory reform?

9 A No, I did not.

10 Q Has anybody at the SEC ever mentioned financial
11 regulatory reform in connection with the Goldman Sachs
12 investigation or in connection with the filing of an action
13 against Goldman Sachs prior to the case being filed?

14 A No, not to me.

15 Q Do you have any reason to believe that the SEC's
16 action against Goldman Sachs or the timing of that action was
17 related to or specifically to advance financial regulatory
18 reform?

19 A No, I do not.

20 Q Are you aware of any information indicating that
21 the SEC's action against Goldman Sachs or the timing of that
22 action was related or to advance financial regulatory reform?

23 A No.

24 Q Are you aware of any information indicating that
25 the SEC coordinated its action against Goldman Sachs with the

1 Executive Office of the President, the White House or any of
2 its employees?

3 A No.

4 Q Are you aware of any information indicating that
5 anyone at the SEC shared any information concerning its
6 Goldman Sachs investigation with the Executive Office of the
7 President, the White House or any of its employees prior to
8 the complaint being filed?

9 A No.

10 Q Are you aware of any information indicating the SEC
11 coordinated its action against Goldman Sachs with any members
12 of Congress or congressional employees?

13 A No.

14 Q Are you aware of any information indicating that
15 anyone at the SEC shared any information concerning its
16 Goldman Sachs investigation with any members of Congress or
17 any congressional employees prior to the complaint being
18 filed?

19 A No.

20 Q Are you aware of any information indicating that
21 the SEC coordinated its action against Goldman Sachs with the
22 Democratic National Committee, Democratic Senate Campaign
23 Committee, Democratic Congressional Campaign Committee or any
24 of their employees?

25 A No.

1 Q Are you aware of any information indicating that
2 anyone with the SEC shared any information concerning its
3 Goldman Sachs investigation with the Democratic National
4 Committee, the Democratic Senate Campaign Committee, The
5 Democratic Congressional Campaign Committee or any of their
6 employees prior to the complaint being filed?

7 A No.

8 Q Are you aware of any information indicating that
9 the SEC coordinated the settlement of its action with the
10 Executive Office of the President, the White House, its
11 employees, members of Congress or congressional employees,
12 the Democratic National Committee, Democratic Senate Campaign
13 Committee, Democratic Congressional Campaign Committee or any
14 of their employees?

15 A No.

16 Q And are you aware of any information that anyone
17 from the SEC shared any information concerning the Goldman
18 Sachs settlement with the Executive Office of the President,
19 the White House, any of its employees, the members of
20 Congress or congressional employees, the Democratic National
21 Committee, Democratic Senate Campaign Committee, Democratic
22 Congressional Campaign Committee or any of their employees or
23 any other agencies prior to this settlement being announced?

24 A No.

25 Q Do you have any knowledge with respect to the

1 settlement as to why the decision was made to file and
2 announce the settlement the same day that the Commission
3 approved the settlement going forward?

4 A No.

5 Q And were you aware that the day that the SEC
6 announced the settlement was also the day where there was a
7 critical vote on financial regulatory reform?

8 A I am aware that that is what happened.

9 Q Okay. But you weren't aware that -- you aren't
10 aware of any connection between the two?

11 A No, I am not aware of any connection between the
12 two.

13 MR. KOTZ: All right. All right. I don't have any
14 other further questions. The one thing I would ask is in
15 order to preserve the integrity of our investigation that you
16 not discuss the content of your testimony with anyone.

17 THE WITNESS: Okay.

18 MR. KOTZ: All right. With that, we're off the
19 record.

20 (Whereupon, at 3:13 a.m., the examination was
21 concluded.)

22 * * * * *

**Memorandum of Telephone Interviews with Employees of the U.S. District Court
for the Southern District of New York**

1.

(b)(7)(C)

At 1:30 p.m. on Tuesday April 27, 2010, Senior Investigators (b)(7)(C) and (b)(7)(C) spoke via telephone with (b)(7)(C) Financial Clerk at the United States District Court for the Southern District of New York ("SDNY").

(b)(7)(C) stated that the District Court's electronic case assignment system indicates that the SEC's Goldman Sachs complaint was physically filed at the courthouse on April 16, 2010 at 10:29 a.m. (b)(7)(C) stated that the case was opened by a courthouse employee named (b)(7)(C). (b)(7)(C) explained that there are two stamps on documents physically filed during the daytime: a "received" stamp with the date on it and a "clock" stamp with the date and time on it. (b)(7)(C) stated that, if there is a discrepancy between the date on the "received" stamp and the date on PACER and the electronic case assignment system for the complaint, it was most likely the result of human error. (b)(7)(C) also stated that the SEC's complaint filing was not entered into PACE until April 19.

(b)(7)(C) stated that there is no record kept of the names of the individuals who file complaints with the District Court.

(b)(7)(C) stated that the press is allowed three times a day as a privilege to view public cases. (b)(7)(C) believed that those times were in the morning, early afternoon, and late afternoon, but she was not sure. (b)(7)(C) said that these times are posted at the District Court's intake window, and that (b)(7)(C) and (b)(7)(C) are the names of the two individuals who work at the intake window. (b)(7)(C) said that there is a record kept of members of the press who sign out complaints.

(b)(7)(C) stated that, at some point subsequent to the physical filing of the paper complaint, the SEC filed a copy of the complaint electronically, because there would not be a pdf of the complaint in Pacer otherwise (the Clerk of the Court does not scan paper filings into Pacer.)

2.

(b)(7)(C)

Also on April 27, subsequent to the phone call with (b)(7)(C) and (b)(7)(C) spoke via telephone with (b)(7)(C) Docket Services, SDNY. (b)(7)(C) stated that the clock-stamp for the SEC's Goldman complaint was located in the chambers of the judge assigned to the SEC-Goldman case, and that he would send a copy of the clock-stamp for the SEC's Goldman complaint to the OIG via fax later that day. (b)(7)(C) stated that he did not have a copy of the logsheet for those journalists who took out the complaints, and that the OIG would have to send a letter to the clerk of the court, J. Michael McMahon, to request that information.

3.

(b)(7)(C)

Also on April 27, subsequent to the phone call with (b)(7)(C) and (b)(7)(C) spoke via telephone with (b)(7)(C) SDNY. (b)(7)(C) stated that the times during which journalists are allowed to review public filings are 9:00 AM, 11:00 AM, and 3:45 PM. (b)(7)(C) stated that journalists only need to sign a log if they are taking the filings out, not if they are merely reviewing them. (b)(7)(C) also stated that the same group of journalists always sign the filings out.

Memorandum of Interview of

(b)(7)(C)

At 11:15 am on Monday, June 21, 2010, Assistant Inspector General (b)(7)(C) and Senior Investigator (b)(7)(C) interviewed (b)(7)(C) NYSE Regulation, at the Headquarters of the Securities and Exchange Commission (SEC). (b)(7)(C) was represented by (b)(7)(C) NYSE Regulation.

Preliminaries

(b)(7)(C) and (b)(7)(C) first identified themselves and informed (b)(7)(C) of the existence of the Office of Inspector General (OIG) investigation. (b)(7)(C) warned (b)(7)(C) of the penalties for perjury.

Background

(b)(7)(C) stated that, prior to his current position, he was the General Counsel for NYSE Regulation. (b)(7)(C) stated that he was asked to become interim CEO of NYSE Regulation after his predecessor CEO went to succeed Mary Schapiro as the head of FINRA.

Trading Halts

(b)(7)(C) stated that one issue that NYSE regulation considers is whether it should halt trading in the securities of a listed company because material news concerning that company is being disseminated. (b)(7)(C) stated that NYSE Regulation does not want trading in a company's securities to occur as the news is being disseminated for that company. (b)(7)(C) stated that NYSE Regulation likes to have trading in a company's stock halt from the point in time when nobody knows the news about the company, to a point when everybody knows the news, so that people who get the news early are not able to sell their stock earlier than those who did not get the news early. He stated that a halt would typically last as long as it takes for the news about the company to be disseminated and absorbed. He stated this process often takes less than fifteen minutes. He stated that once it is clear that the media has put out the entirety of the press release containing the news about the company, NYSE Regulation will allow trading to resume in the company's securities. If there is an imbalance in the amount of buyers in comparison to the amount of sellers for the company's securities, NYSE Regulation will wait until there is an equilibrium to start trading again.

(b)(7)(C) stated that NYSE Regulation tells listed companies that they should try their best to announce material news outside of the trading day. (b)(7)(C) stated that, if the company needs to announce material news during the trading day, NYSE Regulation asks for advance notice of the news from the company so that NYSE Regulation can determine if the news is material and thus to halt trading at the appropriate time. (b)(7)(C) and (b)(7)(C) provided the OIG staff with a copy of NYSE rules that obligate companies

listed on the NYSE to give advance notice of material news concerning the company, particularly Rule 202.06. (b)(7)(C) stated that it may be a different situation for the SEC as to whether it should give NYSE Regulation advance notice that it is filing an action. (b)(7)(C) stated that he did not know that the SEC typically gives NYSE Regulation advance notice of its actions.

The SEC's Action Against Goldman Sachs

(b)(7)(C) stated that on April 16 of this year, at approximately 10:45 am, (b)(7)(C) received a call from NYSE Regulation's operations group, who informed him that the SEC had filed an action against Goldman Sachs (Goldman) for engaging in securities fraud. He stated that this news was a surprise to (b)(7)(C) and to NYSE Regulation. (b)(7)(C) stated that NYSE Regulation called Goldman to find out more details, and Goldman informed NYSE Regulation that Goldman had received no advance notice that a complaint filing was imminent.

(b)(7)(C) stated that at that time (approximately 10:45 am), CNBC was reporting that the SEC would be holding a press conference at 11:00 AM. (b)(7)(C) stated that there was some confusion at NYSE Regulation at that time concerning the press conference, because it was not clear whether the press conference would contain more news than had already been included in the press release. (b)(7)(C) stated that, if the press conference were to contain more news beyond what was in the complaint, then a halt in the trading of Goldman's stock would be appropriate. (b)(7)(C) stated that he attempted to call Lorin Reisner, Deputy Director of the SEC's Division of Enforcement, at this time, because Reisner was listed as a contact on the press release. (b)(7)(C) stated that he was unable to reach Reisner, and that he either left a message with Reisner's administrative assistant or a voicemail for Reisner to call him. (b)(7)(C) stated that Reisner never returned (b)(7)(C) telephone call.

(b)(7)(C) stated that, at 11:00 am that day (April 16), he listened to the SEC's press conference, and it became clear that the press conference was to announce the Goldman Sachs filing, with no further news, so there would be no need for a halt in the trading of Goldman's stock.

(b)(7)(C) stated that he called (b)(7)(C) Office of Market Surveillance, later that day. (b)(7)(C) stated that he was interested in having a conversation as to how the SEC's action impacted the market. (b)(7)(C) stated that (b)(7)(C) indicated that (b)(7)(C) should be speaking to someone more senior in the SEC about this issue. (b)(7)(C) stated that (b)(7)(C) also indicated to him that (b)(7)(C) himself was not aware in advance of the SEC's action against Goldman Sachs.

(b)(7)(C) stated that he also called (b)(7)(C) of the SEC's Office of Public Affairs, that day. The OIG staff showed (b)(7)(C) an April 16, 2010 e-mail sent at 4:57 pm from (b)(7)(C) to Reisner, copying John Nester, Director of the SEC's Office of Public Affairs, in which (b)(7)(C) describes a telephone conversation with (b)(7)(C) stated that the e-mail accurately summarized his conversation with (b)(7)(C)

(b)(7)(C) stated that neither Reisner nor anyone else at the SEC got back to him concerning the matters he raised with (b)(7)(C) and (b)(7)(C) stated that, over the next few days, he decided not to follow up with the SEC on this issue, because he was not sure that there was a good answer to the market surprise problem. (b)(7)(C) stated that one easy fix for situations in which the SEC plans to hold a press conference concerning the filing of an action would be for the SEC to make clear in its press release for the action filing that the press conference would be to discuss the action.

(b)(7)(C) stated that when he looked at the price movement for Goldman's stock on April 16, he noted that the price of the stock went down and stayed there, as it did for the next couple of trading days.

(b)(7)(C) stated that it did not occur to him that the day the SEC announced its action against Goldman was the monthly options expiration date until the OIG brought this fact to his attention. (b)(7)(C) stated that he is not an expert in options and could not opine as to the impact of the SEC's announcing its action against Goldman on the monthly options expiration date.

(b)(7)(C) stated that he personally thinks that it would be better for the SEC to file its lawsuits against companies listed on the NYSE outside NYSE trading hours, and that others outside the NYSE would agree with him. (b)(7)(C) stated that there is "after-hours" trading from 4:00 am to 8:30 am and from 4:00 pm to 8:00 pm on weekdays, but that there are fewer participants in the market during these hours, the market can be more volatile then, and people who trade during these hours appreciate that there are bigger risks in trading at these times. (b)(7)(C) stated that the NASDAQ market considers their trading hours to be from 7:30 am to 6:00 pm. (b)(7)(C) opined that "the real solution to this" is to get a trading halt set up in advance. (b)(7)(C) stated that not all SEC actions are necessarily material, and that it can be a judgment call as to which actions are material, although the Goldman action clearly was material.

(b)(7)(C) stated that (b)(7)(C) at NYSE Regulation works on insider trading matters, and that (b)(7)(C) often interacts with (b)(7)(C) in connection with such matters.

Conclusion

(b)(7)(C) stated that (b)(7)(C) would be sent, via (b)(7)(C) a confidentiality and nondisclosure agreement which (b)(7)(C) needed to sign and promptly return to the OIG.

The interview concluded at approximately 12:45 pm.

Memorandum of Interview of

(b)(7)(C)

At 3:30 pm on Thursday, August 26, 2010, Senior Investigator
interviewed

(b)(7)(C)

(b)(7)(C)

(b)(7)(C)

(b)(7)(C)

(b)(7)(C) stated that it is practically impossible to predict the effect of announcing material news on the monthly Friday options expiration date, because of speculative open interest. (b)(7)(C) stated that bullish speculators could dramatically influence the price, and that panics do happen. (b)(7)(C) stated that price fluctuations could be exacerbated by material news on the monthly Friday options expiration date, in that the activity could feed on itself, starting in the options market and spilling into the stock market, or vice versa. (b)(7)(C) stated that if people on one side of a transaction are hedged, as proprietary traders usually are, they need to unwind that hedge. (b)(7)(C) stated that those with stop-loss orders could get hurt by this activity, but that it is impossible to predict, and that there is no way in advance to know how this activity will play out.

(b)(7)(C) stated that announcing material information about a publicly traded company during market hours could lead to an instantaneous overreaction in the markets. (b)(7)(C) stated that announcing material information about market hours close allows time for the market to absorb the information and establish a new equilibrium.

The telephone call concluded at approximately 4:00 pm.

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Unknown

From: Cohen, Stephen L.
Sent: Sunday, January 24, 2010 9:56 AM
To: Nisanci, Didem A.; Gillan, Kayla J.; Marlin, Myron L.
Cc: (b)(7)(C)
Subject: ABACUS 2007-AC1
Attachments: ABACUS%202007-AC1.doc

You asked to be kept apprised of cases that were significant. On Thursday's calendar is the Goldman CDO case. The action memo is attached. You can ignore the comments; they are not edits. This electronic version is called an annotated action memo, which is simply a version in which the staff keeps track of the source for each of the key facts. There is a meeting tomorrow morning to discuss GC's concerns about this case. We'll keep you posted.



David McCraw
Vice President and
Assistant General Counsel

620 Eighth Avenue
New York, NY 10018

tel 212.556-4031
fax 212.556-4634

August 31, 2010

VIA ELECTRONIC DELIVERY

(b)(7)(C)

Office of the Inspector General
Securities & Exchange Commission
Washington, D.C. 20549

Re: OIG Investigation No. 534 (Goldman, Sachs)

Dear

(b)(7)(C)

I write in response to your letter of August 20, 2010 requesting certain information from The New York Times ("The Times") concerning its April 16, 2010 website article (the "Article") about the Securities & Exchange Commission's lawsuit against Goldman, Sachs & Co.

I have confirmed that the Article appeared on nytimes.com at 10:38:42. I have consulted with various people here as to whether the version of the Article that appeared at that time is available. It appears that subsequent versions of web stories overwrite earlier versions, and the prior versions are not preserved. I continue to talk to our technical staff to see whether the first version is recoverable and I will keep you apprised.

As for the remaining questions in your letter (Nos. 2 through 4), The Times declines to respond. All of the questions seek information about unpublished information or our newsgathering and editorial decision-making. We believe that all such information is subject to the qualified privileges for confidential and unpublished information under federal common law and the U.S. Constitution. Consistent with our long-standing policy, we do not provide such information in response to request from private litigants or government investigators.

Sincerely,

David E. McCraw



U.S. Securities and Exchange Commission

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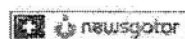
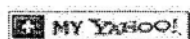
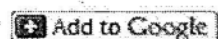
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Tue, 20 Apr 2010 13:13:12 EDT

[Statement From Chairman Schapiro on OIG Report 526: "Investigation of the SEC's Response to Concerns Regarding Robert Allen Stanford's Alleged Ponzi Scheme"](#)

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Fri, 16 Apr 2010 13:55:59 EDT

[SEC Charges Goldman Sachs With Fraud in Structuring and Marketing of CDO Tied to Subprime Mortgages](#)

Release No. 2010-59

Fri, 16 Apr 2010 10:33:44 EDT

SEC Charges Private Equity Firm in Kickback Scheme Involving New York Pension Fund
Release No. 2010-58

Thu, 15 Apr 2010 10:45:02 EDT

Federal Regulators Release Model Consumer Privacy Notice Online Form Builder
Release No. 2010-57

Thu, 15 Apr 2010 10:00:09 EDT

SEC Proposes New Measures to Protect Investors in Options Markets
Release No. 2010-56

Wed, 14 Apr 2010 15:56:06 EDT

SEC Proposes Large Trader Reporting System
Release No. 2010-55

Wed, 14 Apr 2010 15:56:06 EDT

SEC Proposes Rules to Increase Investor Protections in Asset-Backed Securities
Release No. 2010-54

Wed, 7 Apr 2010 17:04:42 EDT

SEC Charges Morgan Keegan and Two Employees With Fraud Related to Subprime Mortgages
Release No. 2010-53

Wed, 7 Apr 2010 11:04:43 EDT

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FW: Goldman

4/14/2010 6:08:24 PM

From: Marlin, Myron L.
To: Cohen, Stephen L.

(b)(7)(C)

Spittler, Eric J.

(b)(7)(C)

Nisanci, Didem A.

(b)(7)(C)

FYI...

-----Original Message-----

From: (b)(7)(C)

Sent: Wednesday, April 14, 2010 6:07 PM

To: Marlin, Myron L.; Nester, John J.

Subject: FW: Goldman

Erik

-----Original Message-----

From: Muoio, Reid

Sent: Wednesday, April 14, 2010 6:04 PM

To: (b)(7)(C)

Subject: FW: Goldman

-----Original Message-----

From: Friestad, Scott

Sent: Wednesday, April 14, 2010 5:03 PM

To: Khuzami, Robert; Reisner, Lorin L.; McKown, Joan; Lench, Kenneth; Muoio, Reid

Subject: Goldman

I wanted to let you know that there's at least one reporter who knows this recommendation is on the calendar today. It's not clear to me how they found out, but I wanted you to be aware of that fact, in case there's going to be any delay in filing the case after it's authorized.

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Memorandum of Telephone Call with Thomas Golden

At 10:00 am on Thursday, August 26, 2010, Senior Investigator (b)(7)(C) received a telephone call from Thomas Golden, Esq., a partner at Willkie Farr & Gallagher LLP, and counsel to Bloomberg News. This telephone call was in response to a request for information made by OIG to David Scheer at Bloomberg News on August 17, 2010, concerning whether, when, and how Bloomberg News was aware that the SEC was considering an action against Goldman Sachs prior to the action being filed.

Golden stated that, "off the record," Bloomberg News did not have advance notice of the SEC's Goldman Sachs action prior to the action. Golden stated that he was working with Bloomberg News to submit a more formal response to OIG's request for information.

The telephone call concluded at approximately 10:10 am.

Subsequently, (b)(7)(C) left messages for Golden at his telephone number, (212) 728-8657, on September 3 and September 13, inquiring as to the status of a more formal response by Bloomberg News to our request for information, but these voicemails have not been returned by Golden, and OIG has not received a more formal response to its request for information.

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RE: Emailing: newsclips.sec.gov

4/19/2010 6:40:39 PM

From: Friestad, Scott
To: McKown, Joan (b)(7)(C)

Wow – this is amazing. I can't understand why someone would do this. It's just going to add fuel to the fire (speculation) that this was politically motivated. I'm hearing that the Chairman's office is denying that there was any connection between the decision to file the case on Friday and the decision to release the Stanford IG report the same day. They had better be careful, because they may get asked for e-mails, etc. from Congress or pursuant to a FOIA request. It could also come up in her testimony tomorrow.

From: McKown, Joan
Sent: Monday, April 19, 2010 5:28 PM
To: Friestad, Scott
Subject: Emailing: newsclips.sec.gov

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Bloomberg News SEC "Said to Have voted 3-2" to Sue Goldman

April 19th, 2010 OPA

Bloomberg News SEC "Said to Have voted 3-2" to Sue Goldman

April 19, 2010

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Partial, closed captioned transcript:

"...as we just told you, a short time ago that securities and exchange commission said to have to three to two — said to have voted three to two to sue the financial firm. the republicans opposed the suit. this was confirmed by two people familiar with the vote. peter cook joins us to breakdown the details from capitol hill."

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Securities and Exchange Commission

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RE: SEC inquiry

7/16/2010 8:07:53 PM

From: Nester, John J.

To: (b)(7)(C)

Rob declined in yesterdays news conf to discuss vote, so we'll stick with that. I'm not at home just now, but each of Comm's has blackberry, and protocol is same for each, except aguilar is aguiliarlu (I guess we we already had an Aguilar!)

From: Louise Story

To: Nester, John J.

Sent: Fri Jul 16 20:03:04 2010

Subject: SEC inquiry

John,

Â hi there. Could you let me know if the commission has any comments on the split vote over approving the Goldman settlement? Also, do you know what #s I'd try to see if any of the individual commissioners have comments?

Thanks, I'm on deadline tonight.

-Louise

--

Louise Story

The New York Times

(b)(7)(C)

Louise's Reporter Page:

http://topics.nytimes.com/topics/reference/timestopics/people/s/louise_story/index.html

<http://twitter.com/louisestory>

FOIA CONFIDENTIAL TREATMENT
REQUESTED BY GOLDMAN, SACHS & CO.

UNITED STATES OF AMERICA

before the

SECURITIES AND EXCHANGE COMMISSION

-----X
In the Matter of ABACUS CDO
-----X

File No. HO-10911

SUBMISSION ON BEHALF OF GOLDMAN, SACHS & CO.

Richard H. Klapper
Michael T. Tomaino, Jr.
Christopher J. Dunne
SULLIVAN & CROMWELL LLP
125 Broad Street
New York, NY 10004

Attorneys for Goldman, Sachs & Co.

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UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

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In the Matter of ABACUS CDO
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File No. HO-10911

SUBMISSION ON BEHALF OF GOLDMAN, SACHS & CO.

Goldman, Sachs & Co. ("Goldman Sachs") makes this submission in response to the Staff's proposed recommendation that an enforcement action be brought against Goldman Sachs.¹ No such action is warranted.

¹ This submission is provided solely in connection with the Staff's consideration of possible action against Goldman Sachs, and is made without any admission that the conduct under investigation violated any laws, rules or regulations. Should the Staff decide to make any recommendation that varies in any respect from the issues and positions Goldman Sachs has addressed, we expressly reserve the right to revise this submission in accordance with Rule 5(c) of the Commission's Rules Regarding Information and Other Proceedings, 17 C.F.R. § 202.5(c), and Procedures Relating to the Commencement of Enforcement Proceedings and Termination of Staff Investigations, Nos. 33-5310, 34-9796, 1972 WL 130244, at *1-2 (Sept. 27, 1972). Goldman Sachs also expressly reserves the right to object to the admissibility of this submission and those submitted by any other person in any subsequent proceeding. Finally, Goldman Sachs hereby asserts that this submission constitutes attorney work product and requests that (a) it be treated confidentially and not as a waiver of any privilege or immunity from production, and (b) pursuant to Commission Rule 83, 17 C.F.R. § 200.83, that this submission not be disclosed in response to any request made under the Freedom of Information Act, 5 U.S.C. § 552.

PRELIMINARY STATEMENT

In early 2007, Goldman Sachs acted as the underwriter of privately-placed notes issued in a synthetic CDO transaction known as ABACUS 2007-ACI ("2007-ACI"). There was nothing unusual or remarkable about the transaction or the portfolio of assets it referenced. Like countless similar transactions during that period, the synthetic portfolio consisted of dozens of Baa2-rated subprime residential mortgage-backed securities ("RMBS") issued in 2006 and early 2007 that were identified in the offering materials (the "Reference Portfolio"). As in other synthetic CDO transactions, by definition *someone* had to assume the opposite side of the portfolio risk, and the offering documents made clear that Goldman Sachs, which took on that risk in the first instance, might transfer some or all of it through a hedging and trading strategies using derivatives. Like other transactions of this type, all participants were highly sophisticated institutions that were knowledgeable about subprime securitization products and had both the resources and the expertise to perform due diligence, demand any information that was important to them, analyze the portfolio, form their own market views and negotiate forcefully at arm's length. And like other transactions with similar lower-rated subprime portfolios, 2007-ACI's performance was battered by the unprecedented subprime market meltdown, which has impaired cashflow to countless noteholders in such transactions and caused many participants in the market to fail altogether.

Now, with the benefit of perfect hindsight about the magnitude of the market downturn, the Staff proposes to charge Goldman Sachs with misrepresenting material facts relating to the offering. Notably, the Staff does not contend that anything about the Reference Portfolio itself was incorrectly disclosed. Rather, the Staff's theory relates exclusively to the role of Paulson & Co., Inc. ("Paulson") — now recognized as a heavy hitter against the subprime market but at the time a relatively unknown hedge fund manager — in making suggestions to the

independent selection agent as to the composition of the Reference Portfolio and taking a negative position on that portfolio through a swap with Goldman Sachs. Moreover, the Staff proposes not only to base its charges on theories of negligence under Section 17(a) of the Securities Act of 1933, but also to assert that Goldman Sachs made *intentional* misrepresentations concerning Paulson in violation of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder. There is no basis in the law, the record or common sense for such charges.

First, what was important to the note investors, as embodied in Regulation AB, were the offering documents' descriptions of the Reference Portfolio and the distribution of proceeds, which sophisticated institutional investors in asset-backed securities input into their models in order to make their investment decisions based on their views of market and housing trends. This information was accurately disclosed, and the Staff does not contend otherwise. By contrast, we are aware of no synthetic CDO offering that disclosed how the protection buyer would manage the risk it took on, other than to disclose generally that it may do so, as occurred here. Certainly, nothing in Regulation AB requires disclosure of the underwriter's risk management plans, which may shift as parties change their market views and adjust their risk tolerance over time.

Second, given the absence of an affirmative directive in Regulation AB to disclose the involvement of Paulson, the Staff relies on a theory that references in the offering documents to the Portfolio Selection Agent were misleading because they somehow implied that the agent, ACA Capital Management LLC ("ACA"), picked the portfolio in isolation without input from any participant, including ones whose true economic interests at the time were opposite those of the noteholders. But the Reference Portfolio, however it was selected, was

fully disclosed and available for all to evaluate on its merits. To the extent that investors took comfort from ACA's involvement, it was only because an independent expert had approved the portfolio, and that is precisely what ACA did. ACA plainly exercised its own judgment in deciding which securities were included (whatever its impression as to the economic interests of Paulson), rejected dozens that it disliked, and was entirely satisfied with the resulting portfolio. Indeed, ACA put its own money behind its analysis by investing in the notes itself and entering into a large swap referencing the portfolio. There is no industry definition of "Portfolio Selection Agent" that implied that ACA would operate within an ivory tower or refuse to consider suggestions made by interested parties in exercising its independent judgment. In fact, it was a customary feature of the market that participants (including those here) often offered their views on potential securities to be included in referenced portfolios, so no one would have been surprised that Paulson was doing so.

Third, and more fundamentally, while Paulson's investment strategy and success are well known today, nothing in the record establishes that Paulson's involvement would have been significant in early 2007 to anyone involved in the 2007-ACI transaction. All participants in the transaction understood that *someone* had to take the other side of the portfolio risk, and the offering documents clearly stated that Goldman Sachs might lay off some or all of the short exposure to the portfolio that it had taken on. A disclosure that the relatively unknown Paulson was the entity to which Goldman Sachs transferred that risk would have been immaterial to investors in April 2007.

Fourth, there is no basis to suggest that the portfolio would have performed any differently or that the economic outcome for the participants would have changed in the least had Paulson's role and interest been more transparent. The portfolio that ACA originally selected

had the same characteristics as the Reference Portfolio, and both experienced virtually the same poor performance in the face of the subprime meltdown. Further, the principal note investor, IKB Deutsche Industriebank AG ("IKB"), was an active investor in the CDO markets, had expressed its specific interest in transactions like 2007-AC1, had invested in similar ABACUS transactions before, and thoroughly evaluated the portfolio. ACA was a major player in the CDO marketplace with billions under management and had every reason – reputationally and economically – to perform its job well. ABN-Amro ("ABN"), which intermediated Goldman Sachs' swap with ACA, showed little interest in the portfolio and relied instead as a swap intermediary on the credit of its other swap counterparty, ACA, which proved fatal when ACA failed. In the end, every portfolio of lower-rated subprime RMBS was decimated in the market meltdown, and any marginal differences in bond quality underlying the Staff's theory would not have resulted in any materially different outcome.

Fifth, beyond these fatal deficiencies in the Staff's materiality theory, there is no basis for a finding that Goldman Sachs made any alleged misrepresentations about Paulson's role with the negligence required under Section 17(a), much less with the *scienter* mandated by Section 10(b). The Staff has pointed to two ambiguous statements contained in an e-mail from Goldman Sachs that it contends caused ACA to infer that Paulson would be an equity investor. As an initial matter, it is difficult to reconcile such an inference with the Staff's theory that Paulson tried to influence ACA to select dozens of riskier Baa2-rated securities, which would have raised questions about Paulson's true economic interests for any sophisticated market participant. The record, in all events, contains no evidence that Goldman Sachs caused ACA to infer that Paulson had an equity position. Nor does the record support the conclusion that any confusion by ACA as to the nature of Paulson's involvement in 2007-AC1 changed how ACA

selected the Reference Portfolio. Similarly, the absence of any disclosure of Paulson's role did not affect IKB's decision to invest. IKB regularly invested through Goldman Sachs and other firms in numerous CDOs and other complex securities and conducted its own evaluations of the underlying reference portfolios, including for the 2007-ACI transaction.

Finally, the Staff's proposed theory ignores the fact that, as a broker-dealer acting as an intermediary on behalf of a client, Goldman Sachs had a duty to keep information concerning its client's (Paulson's) trades, positions and trading strategy confidential. The Staff itself has recognized this obligation in other contexts, but seeks here to impose a duty to disclose the identity and market views of swap counterparties.

In short, the Staff's contention that Goldman Sachs had a duty to disclose Paulson's involvement in the process by which ACA selected the portfolio is without support in either the factual record or the law, would impose obligations not recognized in existing law and would be directly contrary to market practice, where broker-dealers intermediate between parties taking opposite views and do not disclose those parties' identity or roles to each other. No enforcement action is warranted even on the existing record. If this matter is litigated, Goldman Sachs is confident that a fuller record — including its own discovery of all transaction participants — will underscore that no one in fact considered Paulson's role important and that no one was misled.

THE RECORD

A. Relevant Parties

1. Goldman Sachs

Goldman Sachs is a leading global investment banking, securities and investment management firm that provides a wide range of services worldwide to a substantial and diversified client base that includes corporations, financial institutions, governments and high-

net-worth individuals. Through its mortgage group, Goldman Sachs structured and distributed RMBS and CDO-related products.

2. *ACA*

ACA was the asset management subsidiary of ACA Capital Holdings, Inc., and provided asset management services and credit protection products to investors. As of May 31, 2007, ACA was managing "26 outstanding CDOs with underlying portfolios consisting of \$17.5 billion of assets." (GS MBS-E-003525837.) ACA acted as the Portfolio Selection Agent for the 2007-AC1 transaction, invested \$42 million in the 2007-AC1 notes, and sold protection to Goldman Sachs on the \$909 million notional amount super senior tranche of the transaction.

ACA suffered serious financial troubles at the end of 2007 and beginning of 2008. In November of 2007, ACA posted a \$1.04 billion third-quarter loss. After a restructuring supervised by the Maryland Insurance Administration (Maryland's insurance commissioner), ACA Capital Holdings, Inc. is now operating under the name Manifold Capital. ACA is currently operating as a run-off financial guaranty insurance company.

3. *Paulson*

Paulson is an employee-owned hedge fund founded in 1994. Beginning in 2006, Paulson created two funds, the Paulson Credit Opportunities Funds, which took a bearish view on subprime mortgage loans by purchasing protection through credit default swaps ("CDSs") on various debt securities. These funds earned substantial profits, and have recently received significant media attention. At the time that 2007-AC1 was being transacted, however, Paulson's investment strategy was not yet widely known in the industry. (See Kreitman Tr. 40-41; Herald-Granoff Tr. 25.) Paulson now has more than \$30 billion under management.

4. *IKB*

IKB is a German Bank founded in 1924. In January of 2007, IKB Credit Asset Management, the asset management arm of IKB, had approximately "\$23.9 billion of assets under management" and "over \$16.8 billion of [collateralized loan obligations]/CDOs [had been] launched and managed within IKB group." (GS MBS-E-007698102.) IKB publicly stated that "Securitization and CDO investments are an integral part of IKB AG's business model." (*Id.*) IKB was a highly sophisticated institutional investor that marketed itself as a CDO manager with:

- a large investment team, including 20 portfolio managers and analysts and 20 compliance, IT, legal and operations and surveillance staff;
- "one of the largest databases of CDO structures and performance";
- a "[m]arket leading ABS/CDO evaluation and surveillance platform"; and
- "extensive ABS focused research capabilities and relationships."

(GS MBS-E-007698113; GS MBS-E-007698102.) Indeed, in January of 2007, IKB launched Rhinebridge Plc, a structured investment vehicle that invested heavily in the United States subprime market. Rhinebridge Plc was to be the "flagship vehicle in IKB CAM's expansion into ABS asset management." (GS MBS-E-007698102.)

IKB invested in multiple ABACUS transactions through Goldman Sachs, including ABACUS 2004-1, 2005-3, 2006-11, 2006-15, 2006-8 and 2007-AC1. (See GS MBS 0000018045-18046; Tourre Tr. Vol. 1, 16.) In fact, IKB made the reverse inquiry that led to the first ABACUS transaction, ABACUS 2004-1. (See Tourre Tr. Vol. 1, 16.) In late 2006 and early 2007, Goldman Sachs was working with IKB on a number of transactions, including multiple ABACUS transactions. (See Nartey Tr. 23.)

5. *ABN*

ABN is a Dutch bank currently owned by RFS Holdings B.V. ABN was in the business of intermediating CDS between parties that would not or could not accept each other's credit risk. In 2007-ACI, Goldman Sachs would not accept ACA's credit risk without an agreement to post cash collateral, which ACA would not provide. (See Gerst Tr. 75.) ABN agreed to intermediate the protection that ACA sold to Goldman Sachs on the super senior tranche of the 2007-ACI transaction by entering into a CDS with Goldman Sachs and agreeing to post collateral, and then entered into a back-to-back CDS with ACA. (See Gerst Tr. 75.) ABN appears to have evaluated only ACA's corporate credit rating, and had little or no interest as to the Reference Portfolio. (GS MBS-E-002485173.) Prior to agreeing to intermediate the transaction, ABN purchased from Goldman Sachs a \$27 million CDS providing ABN protection if ACA's credit weakened. (GS MBS-E-003528155.)

B. **The Subprime and CDO Market**

A CDO is a debt security collateralized by debt obligations, including mortgage-backed securities in many instances. These securities are packaged and held by a special purpose vehicle ("SPV"), which issues notes that entitle their holders to payments derived from the underlying assets. In a synthetic CDO, the SPV does not own a portfolio of actual fixed income assets, but rather enters into CDSs that reference the performance of a portfolio. The SPV does hold some collateral securities (separate from the reference portfolio), which it uses to meet its payment obligations.

Beginning in 2005, the market for CDOs expanded extremely rapidly. According to a study performed by the Securities Industry and Financial Markets Association ("SIFMA"), the Global CDO Issuance Volume for 2005 and 2006, not including unfunded synthetic tranches, was approximately one trillion dollars. (SIFMA, Global CDO Market Issuance Data, available

at www.sifma.org/research/pdf/CDO_Data2008-Q4.pdf (last visited Sept. 10, 2009).) The markets for mortgage-backed securities became volatile and unpredictable in late 2006 and early 2007. Investors and speculators in those markets developed conflicting views of the future direction of the principal factors that drove the market — housing prices, interest rates, defaults and delinquencies, delinquencies on loans made by different originators or in different regions of the country, the health of subprime originators and other factors — all of which were entirely within the public domain. Some hedge funds, including Paulson's funds, bet aggressively against the mortgage market, while other investors and speculators believed that any weakness in the housing markets or RMBS would be temporary and mild. Up to the middle of 2007, no one view of the market predominated.

C. The ABACUS Transactions Generally

The ABACUS transactions were synthetic CDOs in which the CDO entities sold notes referencing specific portfolios of securities. The proceeds from the sale of the notes were used to purchase collateral securities, which were held by the SPV. At the same time, the SPV entered into a CDS transaction, whereby it agreed to provide a "protection buyer" with "insurance" payments in the event of write-downs on the referenced securities in exchange for periodic premium payments. These premium payments, along with interest on the collateral securities, were used to pay the noteholders. The collateral securities themselves were used either to pay principal to noteholders or to make payments due to the protection buyer under the CDS, depending on the performance of the reference portfolio. The first ABACUS transaction was ABACUS 2004-1, which was developed in response to IKB's desire to invest in AAA, AA and A rated CDO notes referencing a portfolio of high-grade asset-backed securities. (Tourre Tr. Vol. 1, 16, 24.)

D. ABACUS 2007-ACI

ABACUS 2007-ACI ("2007-ACI") was a synthetic CDO transaction referencing a \$2 billion portfolio consisting of 90 Baa2-rated subprime RMBS issued in 2006 and early 2007. (GS MBS-E-005974542; GS MBS-E-002407039-2407041.) The securities issued in the 2007-ACI transaction were offered in a private placement pursuant to Rule 144A. (GS MBS 0000010089.)

1. *The Paulson Reverse Inquiry*

In late 2006, Paulson initiated a "reverse inquiry" by approaching Goldman Sachs to determine whether it would enter into a CDS in which Paulson bought protection on a portfolio of Baa2-rated RMBS from the 2006 vintage. To mitigate the significant market risk that it would take on if it entered into the CDS, Goldman Sachs structured two separate transactions.

In the first transaction, Goldman Sachs created the 2007-ACI SPV, which would issue notes and enter into a CDS through which Goldman Sachs would purchase credit protection on a portfolio of Baa2-rated 2006 vintage subprime securities. The investors that bought the notes issued by the SPV would, by definition, be taking the view that the securities in the Reference Portfolio would perform at least moderately well, while Goldman Sachs as credit protection buyer took the contrary view that those securities would perform poorly. In the second transaction, Goldman Sachs would enter into the CDS that Paulson had requested. To the extent that Paulson's requested CDS portfolio matched the 2007-ACI Reference Portfolio, Goldman Sachs would effectively neutralize its market risk. (GS MBS-E-003272296; GS MBS-E-003272305.) David Gerst and Fabrice Tourre explained this dual structure to the Staff. (See Tourre Tr. Vol. 1, 95; Gerst Tr. 139.)

2. *The Portfolio Selection Process*

ACA, the Portfolio Selection Agent for 2007-AC1, had extensive experience and a strong reputation in the industry. In its role as Portfolio Selection Agent, ACA was to select a portfolio of Baa2-rated RMBS from the 2006 and 2007 vintages to comprise the Reference Portfolio, but would not provide any ongoing asset management or other services.

Goldman Sachs started the portfolio selection process by providing Paulson with a database of RMBS securities and a spreadsheet listing securities that fit Paulson's requirement that the portfolio be restricted to 2006-vintage subprime RMBS that were rated Baa2 by Moody's Investor Service and approximately BBB by Standard & Poor's. (Gerst Tr. 13-14.) Paulson then provided Goldman Sachs with a spreadsheet of 123 securities. Goldman Sachs sent this spreadsheet of 123 securities to ACA for its evaluation and potential inclusion in the 2007-AC1 Reference Portfolio. (GS MBS-E-007974381.)

ACA evaluated each of the 123 securities using its proprietary models and methods of analysis. ACA rejected more than half of the securities, and sent Goldman Sachs a revised spreadsheet listing 86 securities, including 55 from the list of 123 securities and 31 additional 2006-vintage Baa2-rated securities. (GS MBS-E-002537707.) ACA later proposed an additional 26 reference securities. (GS MBS-E-002480599.) Goldman Sachs suggested that two of the proposed securities be rejected, and ACA suggested three replacements. (GS MBS-E-003026086.)

ACA and Paulson then met on February 2, 2007 to discuss the reference portfolio. During this meeting, Paulson proposed a list of securities, nine of which ACA had already rejected. After the meeting, ACA emailed Paulson and Goldman Sachs, reiterating its rejection of the nine securities and attaching a spreadsheet listing 100 securities (79 of which previously had been approved by Paulson and ACA). (GS MBS-E-0038338442.) Paulson suggested

removal of eight of the securities (seven of which were removed) and Goldman Sachs suggested removal of two of the securities (one of which was removed). (GS MBS-E-002483508; GS MBS-E-002983660.) Paulson then circulated a list of 90 reference securities. Of these 90, ACA requested that the parties make substitutions for three of the securities. (GS MBS-E-003782252; GS MBS-E-002445333.) ACA proposed eleven alternative securities and Paulson agreed to three out of those eleven securities. (GS MBS-E-002444961-2444962; GS MBS-E-002445333-2445334; GS MBS-E-002444961-2444962.) ACA thereafter agreed to the removal of three New Century securities, and the substitution of three securities to include in the final portfolio.² (GS MBS-E-003740868; GS MBS-E-003740867-3740869.)

ACA ultimately approved 90 securities that it stood behind as the portfolio selection agent, albeit from the category of 2006/2007-vintage Baa2-rated subprime RMBS. There is no indication that ACA "rubber stamped" any of the securities suggested by Paulson, or that it behaved in any way that was inconsistent with the normal obligations of a Portfolio Selection Agent. And as a sophisticated market player that managed billions of dollars in subprime securities, ACA should easily have recognized any tendencies or marginal biases in the securities that Paulson recommended.

3. *Marketing and Sale of the 2007-ACI Transaction*

Because of IKB's prior interest in ABACUS transactions, Goldman Sachs approached IKB as a potential investor in 2007-ACI. IKB ultimately decided to purchase \$150 million in senior certificates with the view that it would have a relatively protected senior position in a risky portfolio. (See GS MBS 0000018046.) ACA purchased \$42 million worth of

² IKB had previously expressed concern over RMBS for which New Century and Fremont were the servicers, which may have been the reason for removing those securities. (GS MBS-E-002972269.)

senior secured notes. (GS MBS 0000018046.) The 2007-AC1 transaction closed on April 26, 2007. The SPV used the proceeds of the sale to purchase AAA-rated certificates to hold as collateral.

Goldman Sachs entered into a CDS with the SPV in a notional amount of \$192 million in which Goldman Sachs agreed to make premium payments in return for protection on the Reference Portfolio. In addition to the CDS purchased from the SPV on May 31, 2007, Goldman Sachs also entered into a \$909 million notional amount CDS referencing the super-senior (50-100%) tranche of the 2007-AC1 CDO. (GS MBS 0000018052.) ABN served as intermediary for this trade by entering into the \$909 million CDS with Goldman Sachs and an offsetting CDS with ACA, thereby assuming credit risk if ACA was unable to pay. (GS MBS-E-002485172-2485173.) ABN appears to have principally evaluated only ACA's corporate credit rating before entering into the CDS.³ (GS MBS-E-002485172-2485173.) The record does not indicate whether ABN entered into other CDS trades with ACA, but Goldman Sachs is confident that a full record would reflect ABN's familiarity with ACA and consistent approach to such transactions as solely credit decisions.

E. The Credit Default Swaps Between Goldman Sachs and Paulson

Through CDSs with Paulson, Goldman Sachs sold all of the protection that it had purchased from the SPV and from ACA (through ABN). (Poulin Tr. Vol. 1, 33.) Because Goldman Sachs purchased protection from ACA on a portion (50-100%) of the super senior tranche, but wrote protection to Paulson on the entire (45-100%) super senior tranche, it bore the

³ In connection with this evaluation, ABN purchased \$27 million in corporate CDS protection on ACA from Goldman Sachs, which entitled it to payment if ACA's credit rating fell below a certain level. (GS MBS E-003528155.)

risk that poor performance of the Reference Portfolio would affect the 45-50% portion. (Tourre Tr. Vol. 1, 33.)

The 2007-AC1 Offering Circular could not have been more clear that Goldman Sachs might enter into transactions to increase, reduce or even eliminate its exposure to the SPV:

- "The Protection Buyer is not required to have any credit exposure to any Reference Entity or any Reference Obligation." (GS MBS 0000010105.)
- "[T]he Protection Buyer . . . may hold long or short positions with respect to Reference Obligations and/or other securities or obligations of related Reference Obligations and/or other securities or obligations of related Reference Entities and may enter into credit derivative or other derivative transactions with other parties pursuant to which it sells or buys credit protection with respect to one or more related Reference Entities and/or Reference Obligations. . . . [i]f the Protection Buyer . . . holds claims against a Reference Entity or a Reference Obligation other than in connection with the transactions contemplated in this Offering Circular, such party's interest as a creditor may be in conflict with the interests of the Issuer." (GS MBS 0000010127.)

Nothing stopped any other transaction participant — from the noteholders, to ABN, to Paulson — from similarly reducing or adjusting their own exposure depending on their own perceptions and views as market and economic conditions evolved.

F. The Collapse of the Subprime Market

As was clear to all of the parties, the market for securities backed by subprime loans had already begun to weaken in late 2006, as housing prices stopped increasing and began to decline in some regions of the country. The ABX HE 06-2 BBB Index⁴, which referenced BBB securities issued in the second half of 2006, decreased in early 2007, reaching a low of \$67 on February 27, 2007. It rebounded to as high as \$84.5 on May 24-25, 2007 (a week before ACA, ABN and Goldman Sachs entered into the \$909 million CDS), and then dropped.

⁴ The ABX HE Indices, or Asset-Backed Securities Indices, are synthetic indices distributed by Markit Group, Limited. Each references a basket of 20 CDSs on subprime mortgage-backed securities of a specific vintage and rating.

precipitously from \$80.875 on June 11 to \$20.5 at the end of 2007. (See Appendix 1.) The securities in the Reference Portfolio, which in April 2007 were rated Baa2 by Moody's Investor Service and at or around BBB by Standard & Poor's, were severely affected. The historical performance data relied on by rating agencies, investment banks, government agencies and other participants in the market turned out to be an unreliable predictor of future prices and performance. As reflected by the prices of the ABX indices in early 2007, most sophisticated market participants – including senior government officials – did not predict the severity and breadth of the downturn in U.S. housing markets, and many suffered dramatic losses as a result.

The significant divergence between the expected and actual performance of Baa2-rated RMBSs resulted in large part from the unanticipated severity and breadth of housing market price declines, and the weakening of local economies throughout the United States. The combination of high loan-to-value ratios, the unexpected severity and speed of deterioration in residential housing prices throughout the country and the lack of available refinancing provided little incentive for borrowers to continue making payments on mortgage loans on properties in which they had little or no equity. See, e.g., *Semiannual Monetary Policy Report to the Congress*, Statement of Ben Bernanke, Chairman, Board of Governors of the Federal Reserve System (Mar. 28, 2007). In addition to these unexpected economic factors, an unknown amount of fraud by borrowers, originators, brokers, appraisers and others involved in the loan origination process may have resulted in underwriting of material numbers of loans to borrowers lacking either the means to (or the intention of) making payments on the loans. See, e.g., Tyler Cowen, *So We Thought, But Then Again ...*, N.Y. TIMES, Jan. 13, 2008, at 6; Carolyn Said, *Plenty of Blame for Lending Mess; Mortgage Meltdown*, S.F. CHRON., Feb. 3, 2008, at C1.

THE STAFF'S INVESTIGATION AND ALLEGATIONS

The Staff's investigation of 2007-ACI began on August 29, 2008. The Staff has taken five days of testimony from five Goldman Sachs witnesses: Gail Kreitman and Melanie Herald-Granoff, Michael Nartey, Fabrice Tourre, and David Gerst. Goldman Sachs has produced approximately 8,000,000 pages of documents to the Staff.

Goldman Sachs understands that the Staff currently proposes to recommend that the Commission bring an enforcement action against Goldman Sachs alleging violations of Section 17(a) of the Securities Act of 1933 and Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder. The Staff contends that:

- Goldman Sachs deceived ACA by leading ACA to believe that Paulson would invest in the equity tranche of 2007-ACI, thereby allegedly causing ACA to believe that Paulson had the same interests as ACA when Paulson's interests were, according to the Staff, the opposite of ACA's interests.
- Goldman Sachs deceived investors in the 2007-ACI transaction by describing ACA as the Portfolio Selection Agent when, in fact, Paulson had played a significant role in selecting the Reference Portfolio.

To Goldman Sachs' understanding, the Staff's theory is that Goldman Sachs should have made the role of Paulson in the 2007-ACI transaction clear to ACA, and disclosed that role (and Paulson's identity) in the offering documents. If the Commission chooses to proceed against Goldman Sachs, the Staff has indicated it will seek disgorgement of Goldman Sachs' profits on the 2007-ACI transaction, as well as penalties and injunctive relief.

DISCUSSION

I. THE ABACUS OFFERING DOCUMENTS CONTAINED NO MATERIAL MISREPRESENTATIONS.

To prove materiality under Sections 10(b) and 17(a), the Commission must show a "substantial likelihood" that the alleged misstatement or omission would be deemed significant by a reasonable investor in light of the "total mix" of information available about the investment

at the time the investment decision is made. *Basic, Inc. v. Levinson*, 485 U.S. 224, 231-32 (1988). In evaluating whether an alleged misrepresentation was material, the offering documents must be read as a whole, focusing not "on whether particular statements, taken separately, were literally true, but whether defendants' representations, taken together and in context, would have mis[led] a reasonable investor about the nature of the [securities]." *DeMaria v. Andersen*, 318 F.3d 170, 180 (2d Cir. 2003) (emphasis added).

The offering documents for the 2007-ACI transaction provided all material information that the sophisticated institutional investors here required — most fundamentally, the particulars of the portfolio that the investors could (and did) analyze and evaluate on an equal footing with Paulson and Goldman Sachs. The offering documents contained nothing materially false or misleading about ACA's role, and no reasonable investor would have needed disclosures describing the participation of Paulson, which at the time was little-known and only one of many market participants that investors understood routinely took the opposite risk in transactions of this type (and were a structural necessity for synthetic CDOs).

A. The Offering Documents Fully Disclosed the Material Facts Relating to the Reference Portfolio.

Regardless of how the Reference Portfolio was selected, the offering documents comprehensively described each asset backing the securities. Nothing about the selection process affected the inherent value or risks of the Reference Portfolio. The offering documents provided the sophisticated potential investors in 2007-ACI with the material information about the constituent securities that they needed to perform their own analyses and modeling of the creditworthiness and cash flows of the assets underlying their investment.

Regulation AB recognizes that in an asset-backed securities transaction, investors view information about the asset portfolio and the distribution of proceeds as material, because

performance of those assets, as affected by macro-economic factors and trends that any investor can analyze, will dictate the performance of asset-backed securities.⁵ Regulation AB thus focuses on the underlying assets, and sets forth in great detail the disclosures required in offering documents for asset-backed securities, including: (1) the title and type of securities being offered; (2) a summary of the flow of funds, (3) statements detailing servicer or other fees, (4) detailed descriptions of the characteristics of the assets, and (5) a description of any credit enhancement features. *See, e.g.*, 17 C.F.R. §§ 229.1102, 229.1103, 229.1105, 229.1111.

The value of the assets underlying asset-backed securities does not change based on any "inside" information within the issuer's control. No subjective corporate judgments about budgets, sales, reserves or any other matters relevant to traditional corporate issuers impact a portfolio of mortgage-backed securities. Accordingly, Regulation AB's comprehensive disclosure scheme does not require any mention of the underwriter's (or its clients') subjective view of the assets, or a comprehensive listing of all of the parties that had input into the selection of the assets backing the securities. Rather, Regulation AB focuses on disclosures of the objective features of the underlying assets, which allows potential investors to perform their own analyses and evaluations based on their assessment of economic trends, regardless of the views of the underwriter or other entities as to the value of the underlying assets. This focus on the intrinsic character of the portfolio also is consistent with the distinction drawn by the courts between "hard" and "soft" information. Only the former must be disclosed to investors.

⁵ Although the ABACUS notes at issue here were offered pursuant to the limited requirements of Rule 144A, Regulation AB's focus on information about the underlying assets and how the proceeds of those assets will be distributed reflects what is material to an investor in any asset-backed transaction.

Hard information is typically historical information or other factual information that is objectively verifiable. Publicly disclosed, hard information is actionable if false and material. Soft information, on the other hand, includes predictions and matters of opinion. The failure to disclose soft information is actionable only if [it is] . . . virtually as certain as hard facts.

City of Monroe Employees Ret. System v. Bridgestone Corp., 399 F.3d 651, 669 (6th Cir. 2005); see also *Glassman v. Computervision Corp.*, 90 F.3d 617, 631 (1st Cir. 1996) (“[T]he federal securities laws focus on the mandatory disclosure of backward-looking hard information, not forecasts.”).

In accordance with this regulatory focus, the offering documents at issue here set forth *precisely which* RMBS would comprise the Reference Portfolio. (See GS MBS 0000010274-10277.) The offering documents for each of these RMBS in turn disclosed the various categories of information required by Regulation AB, including detailed information concerning the loans held by the trust that issued the RMBS. This is all that was required. The offering documents need not interpret the information they disclose in ways that “might have facilitated an investor’s task,” because “interpretations drawn from the facts presented in the prospectus[]” do not provide new information, and thus cannot “significantly alter[] the ‘total mix’ of the information already presented.” *Benson v. Morgan Stanley Distributors, Inc.*, 420 F.3d 598, 609 (6th Cir. 2005). In light of the extensive, objective disclosures contained in the offering documents, investors, particularly the sophisticated entities at issue here in the context of a Rule 144A offering, had all the information they needed to understand and evaluate the reference securities, just as a consumer purchaser can evaluate a store’s inventory of merchandise regardless of how it was selected, fully understanding that there may be other brands available elsewhere. See *Ley v. Visteon Corp.*, 543 F.3d 801, 808 (6th Cir. 2008) (“The federal securities laws do not ordain that the issuer of a security compare itself in myriad ways to its competitors, whether favorably or unfavorably [I]t is precisely and uniquely the function

of the prudent investor, not the issuer of securities, to make such comparisons among investments.”).

B. The Sophisticated Investors in 2007-ACI Were More Than Capable of Evaluating the Transaction Based on the Portfolio Information.

The sophisticated investors in 2007-ACI were fully capable of evaluating the Reference Portfolio, and nothing in the record suggests that their analysis turned on how the securities were selected here or, for that matter, in any of the countless other transactions they considered over time.

ACA, as described above, was a well-recognized collateral manager as well as a sophisticated investor in CDOs. It was paid to analyze the Reference Portfolio and approved every security in it. It applied rigorous and disciplined financial modeling to evaluate the portfolio, as it did every day with respect to the billions of dollars it managed.

IKB had long described itself as one of the most highly sophisticated CDO investors in the world. (See GS MBS-E-007698102; see also *Conservative Mittelstand lender IKB has transformed itself into Germany's biggest investor in structured credit—with a taste for riskier deals*, RISK, February 1, 2004.) It stated in January 2007 that it had launched and managed approximately \$16.8 billion of its own CDOs and related securities. (GS MBS-E-007698102.) IKB regularly invested through Goldman Sachs and other firms in CDOs and other sophisticated and complex securities, including ABX CUS and other synthetic CDOs in which other parties took the opposite view of the portfolio. (GS MBS 0000018045-18046.) IKB had its own significant capabilities to (a) research and analyze market conditions and relevant underlying loan data (e.g., housing statistics, ABX index prices and volumes, subprime securities pricing levels, origination volumes and performance of loans in securitized pools), and (b) obtain expert and knowledgeable advice and counsel.

Similarly, in early 2007, ABN was "a leading international bank with total assets of EUR 999 [billion]" and "operate[d] more than 4,500 branches in 53 countries" with a "staff of more than 110,000 full-time employees worldwide." Press Release, ABN AMRO, ABN AMRO Announces Sale of ABN AMRO Mortgage Group, Inc. to Citigroup, Jan. 22, 2007, available at <http://www.abnamro.com/pressroom/pressreleasedetail.cfm?ReleaseID=278522> (last visited Sept. 10, 2009). ABN regularly assumed credit risk by "act[ing] as an intermediary on behalf of customers or other third parties or issue[d] guarantees." ABN AMRO Holding N.V., 2006 Annual Report at 204, available at <http://www.shareholder.com/visitors/dynamicdoc/document.cfm?CompanyID=ABN&DocumentID=1448&PIN=&Page=2&Zoom=1> (last visited Sept. 10, 2009). In connection with these activities, ABN's senior management "establish[ed] the credit policies" and "procedures required to analyze, manage and control credit risk." *Id.* ABN closely "monitored on an ongoing basis" the "risk that counterparties might default on their obligations." *Id.*

Consistent with their sophistication, ACA and IKB were Qualified Institutional Buyers within the meaning of Rule 144A. The Master Repurchase Agreement between Goldman Sachs and ACA stated that, with respect to each of the transactions comprising 2007-ACI, ACA agreed that:

It is acting for its own account, and it has made its own independent decisions to enter into that Transaction. It has evaluated for itself whether that Transaction is appropriate or proper for it based upon its own judgment and upon advice from such advisers as it has deemed necessary. It is not relying on any communication (written or oral) of the other party as investment advice or as a recommendation to enter into that Transaction; it being understood that information and explanations related to the terms and conditions of a Transaction shall not be considered investment advice or a recommendation to enter into the transaction. No communication (written or oral) received from the other party shall be deemed to be an assurance or guarantee as to the expected results of that Transaction.

It is capable of assessing the merits of and understanding (on its own behalf or through independent professional advice), and understands and accepts, the terms,

conditions and risks of that Transaction. It is also capable of assuming, and assumes, the risks of that Transaction.

(GS MBS-E-009154451.)

Thus, the investors had more than sufficient resources and market knowledge to evaluate the portfolio based on the inherent characteristics of the securities, demand additional information or changes to the portfolio, and decline to invest if they were not entirely satisfied or preferred other investment alternatives. There is no evidence that they approached this transaction any differently than the countless other similar transactions they considered. If this matter is litigated, Goldman Sachs is confident that a full record will show that their behavior here conformed to their overall investment approaches.

C. To the Extent that Investors Considered ACA's Participation Important, ACA's Role Was Described Accurately.

Significantly, the Staff has not alleged that the offering documents for 2007-ACI misrepresented anything about the Reference Portfolio. Rather, the Staff's position appears to be that investors would have wanted to know that Paulson had input into the *process* by which ACA ultimately selected the RMBS included in the Reference Portfolio, and that the description of ACA as "Portfolio Selection Agent" was therefore misleading without including a description of Paulson's role. That position is fundamentally flawed for several reasons.

As a threshold matter, the Staff's position incorrectly assumes that the term "Portfolio Selection Agent" conveys to investors that the agent selected the portfolio without any input from others. Nothing in the offering documents asserted that ACA was acting in isolation, and no definition of "Portfolio Selection Agent" would create that impression. The Offering Circular, which described ACA's role as Portfolio Selection Agent, merely stated that "[ACA would], pursuant to the Portfolio Selection Agreement . . . select the Initial Reference Portfolio."

(GS MBS-0000010178.) Nowhere did the Offering Circular state that ACA would not consult

with other entities regarding the selection of the Reference Portfolio, and it was common in CDO transactions for participants to offer views in the process of selecting the referenced assets, as Goldman Sachs and IKB did here. (Herald-Granoff Tr. 26; Narty Tr. 18-19, 57 ("I don't think I can recall a transaction we worked on with [IKB], where we didn't have a back and forth on the portfolio").) See *In re Worlds of Wonder Sec. Litig.*, 35 F.3d 1407, 1417-18 (9th Cir. 1994) (common industry practices require no disclosure). Rather, the Offering Circular states only that ACA would "select" the Reference Portfolio, and the record in this investigation has shown that ACA did so. ACA ultimately approved each security for inclusion in the Reference Portfolio. (See, e.g., GS MBS-E-002537707; GS MBS-E-003838442-3838443.)

Indeed, ACA had served as portfolio selection agent or collateral manager for numerous other transactions, and no doubt was accustomed to an interactive selection process. What is important is that ACA used its own expertise and models in scrutinizing and approving the referenced securities and earned substantial fees for doing so. Whether certain securities were initially suggested by Paulson, Goldman Sachs or IKB, ACA subjected the securities proposed for inclusion in the Reference Portfolio to its own proprietary models and analysis. ACA conducted its own analysis and engaged in significant dialogue with Goldman Sachs and Paulson, and it rejected 75 securities that Paulson initially proposed. (See, e.g., GS MBS-E-002537707; GS MBS-E-003838442-3838443; GS MBS-E-007974381.)

There is no evidence that ACA included any securities that it thought were inappropriate. Indeed, ACA demonstrated its confidence in the quality of the Reference Portfolio by purchasing \$42 million worth of ABACUS 2007-AC1 notes and entering into a \$909 million notional value CDS referencing the portfolio. It defies credulity to assert that ACA would have invested \$42 million of its own funds and entered into a \$909 million CDS based on

the Reference Portfolio if it had any concerns about the referenced securities. Although Goldman Sachs has not yet had the opportunity to take discovery of ACA, it is confident that if this matter is litigated, the full record will demonstrate ACA's independence, full conviction about the portfolio it selected and professional work quality in performing its function.

D. Paulson's Economic Interests Were Not Material to Investors.

The Staff's theory appears to be that Paulson's role would have been significant both to ACA in its role as Portfolio Selection Agent and to investors because — like Warren Buffett or E.F. Hutton — it would have raised a red flag that a prominent “short” strategist was betting against the portfolio. Paulson's name and precise role were not material, however, particularly at the time of the transaction.

First, although Paulson's name and his successful strategy of shorting the subprime RMBS market are now well known, they were not in April 2007. Even Goldman Sachs witnesses testified that they had no knowledge of Paulson or its strategies at the time of the 2007-ACI transaction. (See Herald-Granoff Tr. 25; Kreitman Tr. 40-41.) Indeed, the Staff does not contend that ACA had heard of Paulson prior to the 2007-ACI transaction. The fact that Paulson was unknown to ACA — which, as of May 31, 2007, had 26 CDOs valued at \$17.5 billion under management — demonstrates that the fact of Paulson's involvement would not have been material. Nor is there any evidence that IKB or ABN knew of Paulson at the time or would have changed their investment decisions once they fully understood his involvement. Certainly, those will be significant matters in dispute if this matter is litigated.

Second, given the structure of synthetic CDOs such as 2007-ACI, investors understood that *someone* (whether Goldman Sachs, Paulson or another entity) would necessarily be taking a position contrary to the Reference Portfolio. As the CDS counterparty, Goldman Sachs stood to gain if the Reference Portfolio performed poorly (GS MBS 0000010095) unless it

entered into an offsetting CDS with another counterparty. The Offering Documents clearly disclosed that Goldman Sachs was the Protection Buyer, and also that the

Protection Buyer . . . may hold long or short positions with respect to Reference Obligations and/or other securities or obligations of related Reference Entities and may enter into credit derivative or other derivative transactions with other parties pursuant to which it sells or buys credit protection with respect to one or more related Reference Entities and/or Reference Obligations.

(GS MBS 0000010127; *see also* GS MBS 0000010105 ("The Protection Buyer is not required to have any credit exposure to any Reference Entity or any Reference Obligation.")). This is precisely what Goldman Sachs did through its swap transaction with Paulson. The Goldman Sachs-Paulson CDS was from Goldman Sachs' perspective nothing more than a standard risk-mitigating strategy, which is commonplace in the industry (and indeed beneficial to it) and did not require disclosure.⁶ *Donovan v. Am. Skandia Life Assurance Corp.*, No. 02 CV 9859, 2003 WL 21757260, *2 (S.D.N.Y. July 31, 2003) ("Liability does not arise from the failure to disclose that which should be obvious to the average investor."); *In re Ultimate Corp. Sec. Litig.*, No. 86 CIV. 5944 (CSH), 1989 WL 79372, at *2 (S.D.N.Y. July 11, 1989) (no duty to disclose obvious facts, such as risk that executive might leave company in future). Ultimately, some entity would take a position opposite the debt investors — whether Goldman Sachs kept that position or transferred it to another entity (such as Paulson) was not material.

Similarly, the fact that ACA may have perceived Paulson to be an equity investor is of no moment. As a threshold matter, the interests of an equity investor would not necessarily be aligned with those of ACA or other noteholders, and holders of equity may also hold other long or short positions that offset or exceed their equity exposure. Indeed, Laura Schwartz of

⁶ Indeed, as Mr. Tourre testified, the ABACUS platform originated as a way to hedge Goldman Sachs' exposure to RMBS products. (See Tourre Tr. Vol. 1, 20-21.)

ACA understood this from her work on a transaction that closed in December 2006 in which Magnetar, a hedge fund that bought equity and took short positions in mezzanine-level debt, participated. (See GS MBS-E-007992234 ("Magnetar-like equity investor").) Certainly, ACA could have questioned Paulson about its interests if that information were significant to it.

More fundamentally, the Staff does not appear to contend that ACA would have refused to approve the Reference Portfolio or that investors would have declined to proceed with the transaction if they had known of Paulson's precise interest. Indeed, the Staff does not contend that prior to the 2007-ACI transaction ACA even knew that Paulson existed. Paulson's participation in the portfolio selection process did not diminish ACA's extensive analysis. ACA evaluated Paulson's list of 123 securities using its proprietary methods, and rejected more than half of them. ACA then generated its own list of securities, including 31 not proposed by Paulson. Ultimately, ACA vetted and approved all of the 90 securities included in the Reference Portfolio. The mere fact that Paulson — as well as Goldman Sachs and IKB — offered views on the securities proposed for the Reference Portfolio does not support the allegation that ACA failed to perform its duties or compromised its standards.

In short, all of the parties involved evaluated potential investments based on the fundamentals of the securities and not on who offered suggestions as to which securities to include in the Reference Portfolio. There was no "substantial likelihood" that a reasonable sophisticated investor would have deemed Paulson's involvement in selecting the portfolio to be significant in light of the "total mix" of information available. *Basic*, 485 U.S. at 231-32; see also *Capri Optics Profit Sharing v. Digital Equipment Corp.*, 760 F. Supp. 227, 233 (D. Mass. 1991) ("This Court questions whether the information allegedly not disclosed was even material, i.e., information affecting a reasonable investor's decision to invest. No evidence is presented

that Capri would have refrained from investing had those things been done which Capri says ought have been done." (citation omitted)).

E. Investor Losses Were Attributable Solely to the Overall Market Collapse and Not to Any Alleged Misrepresentations by Goldman Sachs.

The Staff appears to suggest that materiality is somehow established by the poor performance of the transaction. But the cause of those losses was the collapse of the subprime market, and not anything unique to this transaction or its disclosures. Goldman Sachs should not be held responsible for losses caused by a general market-wide decline. *Kielgos v. Commonwealth Edison Co.*, 892 F.2d 509, 515 (7th Cir. 1989) ("Securities laws require issuers to disclose firm-specific information . . . [They] needn't disclose the hazards of its business, hazards apparent to all serious observers and most casual ones." (citation omitted)).⁷

There is no evidence that the original reference portfolio proposed by ACA – or any other portfolio of similar securities for that matter – would have performed any differently. To the contrary, any portfolio of this type would have been swept up in the meltdown of the subprime market and experienced considerable write-downs, and none would have materially outperformed the other. (See Appendix 2.) The Reference Portfolio was designed to contain high-risk tranches of RMBS issued in 2006 and 2007, and nearly all Baa2-rated, 2006/2007-vintage subprime RMBS – including those initially proposed by ACA without Paulson's involvement – have suffered materially similar losses. (*Id.*)

⁷ And indeed, the offering documents disclosed these general market risks, stating:

The rate of defaults and losses on residential mortgage loans will be affected by a number of factors, including general economic conditions and those in the area where the related mortgaged property is located, the borrower's equity in the mortgaged property and the financial circumstances of the borrower.

(GS MBS 000001012L)

In that respect, the transaction participants received precisely what they bargained for. When ACA and IKB bought notes in 2007-AC1 or sold protection referencing the 2007-AC1 Reference Portfolio, they took the view that the senior tranches of 2007-AC1 would suffer losses only if a significant percentage of the 90 referenced securities were written down. ACA and IKB ultimately suffered losses not because Paulson played a role in the portfolio selection process, but because *every security* of that rating and vintage decreased in value as a result of unprecedented market events. The Reference Portfolio was a fair representation of the credit quality of 2006/2007-vintage Baa2-rated subprime RMBS; that credit quality, however, turned out to be very poor.

Similarly, ABN's losses stemmed from overall market forces, not anything relating to the disclosure issues the Staff has raised. ABN was in the business of intermediating credit default swaps for monoline insurers such as ACA and, in connection with that business, intermediated the swap between Goldman Sachs and ACA that referenced the super-senior tranche of the 2007-AC1 securitization. (GS MBS-E-002485172-2485174; GS MBS-E-002461503-2461505) ABN principally evaluated ACA's credit rating, ultimately deeming the risks associated with the swap transaction to be acceptable in light of its compensation and appetite for the risk associated with ACA. (See GS MBS-E-002485172-2485173 (Fabrice Tourne tells ABN that entities that had intermediated trades for ACA in the past had "slowly gotten full on ACA's name and that is why we are now trading at the ... wider level for ACA intermediation").) Consistent with this approach, ABN purchased protection from Goldman Sachs in the form of a \$27 million corporate CDS referencing ACA's credit rating. (GS MBS-E-003528155.) To Goldman Sachs' knowledge, ABN did not purchase credit protection referencing the Reference Portfolio.

Nor did ABN give substantive scrutiny to the 2007-ACI transaction itself.

Rather, the discussions between Goldman Sachs traders and ABN focused almost entirely on what compensation would be appropriate for ABN's intermediation. (See *Tourre Tr. Vol. I*, 88.)

ABN's losses (and Goldman Sachs' on the \$27 million CDS it entered into with ABN) were attributable to ACA's collapse, not the characteristics of the Reference Portfolio or any representations pertaining to it.

Finally, nothing stopped any transaction participant from changing its views and adjusting its exposure. The only constant was the Reference Portfolio once it had been selected. If participants suffered losses, they did so solely because they projected that the economic downturn would be less severe than it was.

II. THERE IS NO EVIDENCE THAT GOLDMAN SACHS ACTED NEGLIGENTLY, LET ALONE WITH THE LEVEL OF SCIENTER REQUIRED TO SUPPORT A SECTION 10(b) CLAIM.

A party's fraudulent intent, defined as "a mental state embracing intent to deceive, manipulate, or defraud," is the touchstone of a violation under Sections 10(b) and 17(a)(1). *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 n.12 (1976). Some courts have held that this standard can be met by a showing of "extreme recklessness," which has been described as an "extreme departure from the standards of ordinary care . . . which presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious that the actor must have been aware of it. In other words, it is a lesser form of intent." *SEC v. Steadman*, 967 F.2d 636, 641-42 (D.C. Cir. 1992) (internal quotations omitted). Additionally,

[t]o prove scienter with respect to a non-disclosure, it is not enough to simply show that the defendant was aware of an undisclosed fact that a court later determines is material. Rather, a plaintiff must show that the defendant must have been aware of both the materiality of the undisclosed fact and that its non-disclosure would likely mislead investors.

SEC v. Gane, No. 03-61553-CIV-SEITZ, 2005 WL 90154, at *15 (S.D. FL Jan. 4, 2005) (internal citations omitted); *see also SEC v. Patty*, 891 F.2d 295, 295 (9th Cir. 1989) (stating that “the question is not merely whether [the defendant] had knowledge of the undisclosed facts; rather, it is the *danger of misleading buyers* that must actually be known or so obvious that any reasonable man should be legally bound as knowing.”) (internal citations omitted)).

With respect to Section 17(a)(2) and (3), although the Staff need not establish fraudulent intent, it still must demonstrate the existence of negligence, defined as a departure from the standard of reasonable care. *Aaron v. SEC*, 446 U.S. 680, 687-91 (1980). The reasonableness of conduct must be judged in light of the customs and practices of others in similar circumstances at the time the conduct occurred. *See Cherokee Ins. Co. v. E.W. Blanch Co.*, 66 F.3d 117, 123 (6th Cir. 1995) (insurance broker “acted in accordance with practices customary in the industry at the time”); *Ward v. Hobart Mfg. Co.*, 450 F.2d 1176, 1182 and n.16 (5th Cir. 1971) (design of product consistent with industry practices at the time); Restatement (Second) of Torts § 295A. Compliance with industry standards is a factor (although not dispositive) in determining whether a party met the appropriate standard of care in cases under the securities laws. *See Vernazza v. SEC*, 327 F.3d 851, 861 (9th Cir. 2003) (“relevant to show standard of care necessary to a recklessness inquiry”); *Messer v. E.F. Hutton & Co.*, 847 F.2d 673, 679 (11th Cir. 1988) (same); *Coates v. Heartland Wireless Communications, Inc.*, 100 F. Supp. 2d 412, 425 n.6 (N.D. Tex. 2000) (absent contrary evidence, a defendant who follows industry practices is not liable for fraud under 10(b)); *In re Piper Capital Management, Inc.*, SEC Rel. No. 2163, 2003 WL 22016298, at *8 (Aug. 26, 2003) (“compliance with industry standards is a consideration”). The record in this investigation has revealed no evidence of negligence, let alone fraudulent intent or extreme recklessness.

A. Goldman Sachs Did Not Mislead ACA Regarding Paulson's Involvement in the Portfolio Selection Process.

The Staff's theory is predicated on the notion that ACA believed that Paulson would be an equity investor in the 0-9% tranche of the 2007-AC1 transaction, and that Goldman Sachs intentionally or negligently led ACA to this belief. In support of this contention, the Staff principally cites:

- Laura Schwartz of ACA's January 8, 2007 e-mail to Gail Kreitman in which she wrote "I have no idea how [the Paulson meeting] went - I wouldn't say it went poorly, not at all, but I think it didn't help that we didn't know exactly how they want to participate in the space. Can you give us some feedback?" (GS MBS-E-003499710);
- Fabrice Tourre's January 10, 2007 e-mail to Ms. Schwartz containing the "Transaction Summary" in which he stated that the transaction was "sponsored by Paulson" and included the line: "[0] - [9]%. pre-committed first loss," (GS MBS E-003504901) which the Staff stated described the equity tranche; and
- Ms. Kreitman's e-mail exchanges with Ms. Schwartz on January 14 and 28, 2007 in which Ms. Kreitman did not correct Ms. Schwartz's apparent misunderstanding that Paulson was an equity investor (GS MBS-E-007980762; GS MBS-E-007992234).⁸

Nothing in those e-mails or elsewhere supports an inference of scienter.

To the extent that ACA inferred from the January 10 e-mail that Paulson would act as an equity investor in the transaction, there is no evidence in the record to suggest that Goldman Sachs intended that ACA draw this inference. The Staff has not asserted that Goldman Sachs or Paulson told ACA that Paulson was an equity investor, and Goldman Sachs is not aware that Ms. Schwartz could recall any such representation being made. Mr. Tourre's reference to "[0] - [9]%. pre-committed first loss" did not state that Paulson would be purchasing a long position, and the record contains no evidence indicating what Mr. Tourre meant by this.

⁸ The Staff has also asserted that certain internal ACA documents state that Paulson intended to invest in the equity tranche of the 2007-AC1 transaction. Copies of those documents have not been provided to Goldman Sachs.

statement. Indeed, Mr. Tourre himself testified that he had no recollection of its meaning.

(Tourre Tr. Vol. 2, 145.)

Further, as several Goldman Sachs employees testified, the term "sponsor" is not uniformly defined in the context of a CDO transaction, and it need not refer to an equity investor at all. (See Tourre Tr. Vol. 1, 13 (stating that the term transaction sponsor is "not necessarily a defined term" and "a very loose concept"); Gerst Tr. 105 ("I don't really think of ["sponsor"] as . . . an official designated role in a transaction per se."); Nartey Tr. 31 ("[W]e use [transaction sponsor] in different ways."))

Indeed, the documents and testimony show that that the term "sponsor" was sometimes used to refer to an investor that initiated a reverse inquiry, a counterparty that initiated a reverse inquiry, the entity that selected the portfolio, or Goldman Sachs itself. (See Tourre Tr. Vol. 1, 24 (describing IKB as the "sponsor investor" for the first ABACUS deal); Tourre Tr. Vol. 1, 71 (stating that the term "ACA Sponsorship" in the 2007-AC1 flipbook referred to the fact that ACA selected the 2007-AC1 Reference Portfolio); GS:MBS 0000010036 (ABACUS 2007-AC1 Flipbook dated February 26, 2007) (stating that ABACUS 2007-AC1 was being "sponsored by ACA."); Gerst Tr. 105 (stating that he thought of the investor who "initiated the inquiry" as a transaction sponsor); Nartey Tr. 31 (stating that clients, managers, and Goldman Sachs itself could be deemed a sponsor)). If Ms. Schwartz inferred that Paulson was an equity investor from Mr. Tourre's email, that at most indicates that a misunderstanding occurred. It does not indicate that Goldman Sachs negligently (let alone recklessly or intentionally) led ACA to believe this was the case, particularly in light of the amorphous language from which Ms. Schwartz apparently drew her inference. Indeed, there is no indication that a reasonable professional under the circumstances presented here would have expected Ms. Schwartz to

construe the term "sponsor" to mean that Paulson necessarily was an equity investor. See *Gebhart v. SEC*, 255 F. App'x 254, 255 (9th Cir. 2007) ("The objective component of scienter asks what a reasonably prudent securities professional under the circumstances would have done.")

Additionally, the fact that Ms. Kreitman did not correct Ms. Schwartz's statements that Paulson was an equity investor does not indicate that she attempted to conceal the truth from ACA. The record shows that Ms. Kreitman, who provided sales coverage on ACA, acted as an "intermediary between the [various] trading desk[s] and clients." (Kreitman Tr. 11.) Ms. Kreitman's role in 2007-ACI was to "manage the relationship for ACA," meaning that she "acted as an intermediary between the trading desk and [ACA] facilitating meetings and phone calls." (*Id.* at 27-28.) She did not "attend or participate [in the meetings she arranged]" relating to the 2007-ACI transaction, nor was she "involved in" the creation of the 2007-ACI CDO. (*Id.* at 31-33.) Nothing in the record suggests that Ms. Kreitman understood the significance of Ms. Schwartz's statements suggesting that she believed Paulson to be an equity investor, much less that Ms. Kreitman acted with scienter or departed from the standard of ordinary care by not correcting them. *Salster v. Singer Sewing Mach. Co.*, 361 F. Supp. 1056, 1062 (D. Miss. 1973) ("Reasonable care does not demand perfection.")

Finally, ACA's purported belief that Paulson was an equity investor would have been neither reasonable nor credible if one accepts the major premise of the Staff's theory that Paulson proposed literally dozens of weaker securities that were systematically rejected by ACA. If this premise were true, then a market participant as sophisticated as ACA would have quickly recognized this trend, and questioned at least in its own mind what Paulson's economic interest

was. Certainly, the credibility of ACA's purported interpretation will be subject to vigorous attack in a contested proceeding.

B. No Evidence Supports an Inference that Goldman Sachs Retained ACA or Characterized ACA as the Portfolio Selection Agent in Order to Deceive Investors.

The Staff has focused on Goldman Sachs' reasons for including ACA in the 2007-ACI transaction, citing: (1) statements in a memorandum to the Goldman Sachs Mortgage Capital Committee Memo to the effect that ACA's involvement would enhance the marketability of the 2007-ACI transaction; and (2) an email in which Mr. Tourre wrote, "One thing that we need to make sure ACA understands is that we want their name on this transaction. This is a transaction for which they are acting as portfolio selection agent, this will be important that we can use ACA's branding to help distribute the bonds." (GS MBS-E-006142887.)

The Staff contends that these statements — as well as Jonathan Ego's February 11, 2007 e-mail stating "You know I love it all I'm saying is the cdo biz is dead and we don't have a lot of time left" (GS MBS-E-002633997) — indicate that Goldman Sachs believed that the 2007-ACI securitization could not be marketed without the ACA brand name. Thus, the Staff contends that Goldman Sachs deliberately concealed Paulson's role in order to maintain the "false" appearance that ACA had selected the Reference Portfolio because, without this deception, the transaction would not be marketable. The Staff's theory does not withstand scrutiny.

ACA was no mindless dupe that could be so easily manipulated. It was a significant player in the CDO marketplace, with a strong reputation as a collateral manager and portfolio selection agent. (GS MBS-E-003525837.) IKB was familiar with ACA and respected its skills as a collateral manager. (GS MBS-E-002668754.) Although the documents cited by the Staff show that Goldman Sachs wanted ACA to assume the role of Portfolio Selection Agent,

they provide no basis for concluding that Goldman Sachs did so in order to conceal Paulson's role. ACA indisputably fulfilled its role as Portfolio Selection Agent, and ACA's approval of the 90 reference securities may have appealed to some potential investors, including IKB. The non-disclosure of Paulson's role (and its separate hedging transaction with Goldman Sachs) simply reflected industry practice not to disclose client names and strategies, as well as the lack of materiality of Paulson's name to potential investors. *See Gané*, 2005 WL 90154, at *15 (to prove scienter, plaintiff must show that defendant was aware that non-disclosed fact was material).

Additionally, there is no evidence whatsoever that Goldman Sachs would have had any intention to mislead investors. In fact, the record reflects that the 2007-ACI transaction – which was approved by the Mortgage Capital Committee, an independent committee within Goldman Sachs – was very much routine, and one of numerous CDO transactions underwritten by Goldman Sachs. Although Goldman Sachs certainly hoped to earn profits by structuring the 2007-ACI transaction, it is well established that allegations of fraud cannot rest on this ground alone, because such a “generalized motive . . . could be imputed to any publicly owned, for-profit endeavor.” *Chill v. Gen. Elec. Co.*, 101 F.3d 263, 267 (2d Cir. 1996). More fundamentally, Goldman Sachs would not have compromised its reputation in the industry or its longstanding customer relationships in order to marginally increase its profitability in a single transaction.

Moreover, it has never been industry practice for financial institutions to disclose the identities of clients with which they enter into hedging transactions. Such disclosures would have been particularly unnecessary here, where the existence of the CDS between Goldman Sachs and the SPV – as well as Goldman's right to transfer the risk assumed thereunder – was

disclosed in the offering documents. Goldman Sachs acted appropriately in not disclosing that ACA conferred with Paulson, because Paulson's involvement was not material. See *SEC v. Todd*, No. 03-CV-2230-BEN (WMC), 2006 WL 1564892, at *7 (S.D. Cal. May 30, 2006) (holding that Commission had not proven scienter where, although defendant knew that certain transactions had occurred but did not disclose them, Commission had failed to point to any evidence demonstrating that the defendant "had knowledge of [the] impropriety [of the transactions], or was reckless in not knowing" (emphasis added)).

As to Mr. Egol's February 11, 2007 e-mail, even if that e-mail suggests that Mr. Egol (from whom the Staff did not take testimony) had a negative view of the CDO marketplace, Goldman Sachs' non-disclosure of that view does not indicate that it was using ACA's brand name to perpetrate some fraud on investors by concealing its own market views or those of Paulson. Goldman Sachs certainly could have sponsored the transaction itself without disclosing its own market outlook, because it is well established that market participants need not disclose their internal views of the market, even if those views have implications for securities being offered.⁹ See *Dirks v. SEC*, 463 U.S. 646, 654 (1983) ("A duty [to disclose] arises from the relationship between parties . . . and not merely from one's ability to acquire information because of his position in the market." (internal quotation marks omitted; alterations in original)); *Moss v. Morgan Stanley Inc.*, 719 F.2d 5, 15 (2d Cir. 1983) ("[N]othing in the language or legislative

⁹ Indeed, Mr. Egol's statement that "the cdo biz is dead" did not reflect a belief that widespread CDO failures would occur. Mr. Egol's email addressed an analysis of the then soon-to-be launched Markit ABX HE Tranche Indices ("TABX"). The TABX indices referenced the BBB and BBB- rated tranches of the ABX indices, and provided investors with the ability to gain or hedge exposure to specific levels of risk in the referenced securities, which previously could only be achieved through bespoke CDOs. As a result, the market for bespoke CDOs could suffer because TABX provided a more liquid and transparent way for investors to buy or sell tranche-specific protection.

history of section 10(b) or rule 10b-5 ... suggests that Congress intended to impose a special duty of disclosure on broker-dealers simply by virtue of their status as market professionals"). It certainly cannot be held liable for failing to disclose a counterparty's views.

Once the pertinent facts have been disclosed, investors in asset-backed securities bear responsibility for evaluating the credit quality of the underlying assets. Ultimately, the 2007-ACI transaction sustained losses because of a general decline experienced by RMBS of similar rating and vintage, not because of the particular Baa2-rated securities in the Reference Portfolio.

III. THE STAFF'S THEORY THAT GOLDMAN SACHS COMMITTED FRAUD BY FAILING TO DISCLOSE PAULSON'S ROLE MISCONCEIVES THE FUNCTION AND OBLIGATIONS OF A BROKER-DEALER.

The Staff claims that Goldman Sachs' failure to disclose Paulson's role in the process of selecting the Reference Portfolio is actionable. This assertion, however, rests on two faulty assumptions: (1) that Paulson's involvement—in light of Paulson's now-known market view and investment strategy—would have been material to investors at the time of the 2007-ACI transaction, and (2) that Goldman Sachs was free to disclose Paulson's role if it wished to do so.

The Staff's first assumption relies on hindsight, and is colored by the knowledge that Paulson later went on to record substantial profits by betting against the subprime market. As discussed above (see *supra*, part I(D)), it does not account for the market reality of the time, which was that Paulson was a little-known hedge fund with a market strategy that ran counter to the views of many sophisticated investors. Simply put, to most investors (including ACA and IKB) the name Paulson would not have been significant even if it had been disclosed.

The second assumption overlooks Goldman Sachs' duty as a broker-dealer to keep information concerning its clients' trades and positions confidential. As disclosed in the

Offering Circular, Goldman Sachs was the original protection buyer for the 2007-ACI transaction. The CDSs entered into by Goldman Sachs and Paulson were separate, albeit related, transactions from the 2007-ACI securitization. Indeed, the Staff argued on our July 28, 2009 call that in computing Goldman Sachs' profits it intended to treat the Paulson CDSs as separate transactions that did not offset Goldman Sachs' profits on its CDSs with the SPV and ABN. Leaving aside the lack of logic or fairness of refusing to consider offsetting hedge transactions in computing profit, the Staff did recognize that the Paulson CDSs were separate transactions from those with the SPV and ABN. Given that the offering documents disclosed that Goldman Sachs might enter into just such transactions to convey to other parties the credit protection it purchased in CDSs with the 2007-ACI SPV, the Staff's argument reduces to nothing more than Goldman Sachs' failure to disclose the identity of one of its counterparty clients.

Consistent with one of the fundamental ethical standards governing their conduct, broker-dealers do not have to disclose their clients' positions or strategies to other parties with whom they engage in trades. The Commission itself recently described the obligation not to divulge client information as "one of the most fundamental ethical standards in the securities industry," noting that "[t]he duty to maintain the confidentiality of client information is grounded in fundamental fiduciary principles." *In re Thomas W. Heath, III*, SEC Rel. No. 59223, 2009 WL 56755, at *4 (Jan. 9, 2009) (affirming sanctions against former registered representative of member of national securities exchange who divulged confidential client information).

Through the enforcement action being proposed here, the Staff would create a new disclosure obligation requiring broker-dealers to disclose the identities and positions of their counterparties or customers to other market participants. The creation of this obligation would greatly expand existing disclosure requirements, and would run afoul of the existing obligation to

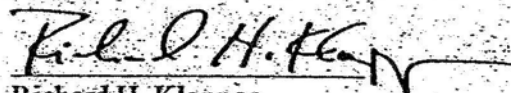
maintain the confidentiality of client transactions. It should therefore be effected – if at all – through formal rulemaking rather than an enforcement action.

CONCLUSION

For the foregoing reasons, no enforcement action is warranted.

Dated: New York, New York
September 10, 2009

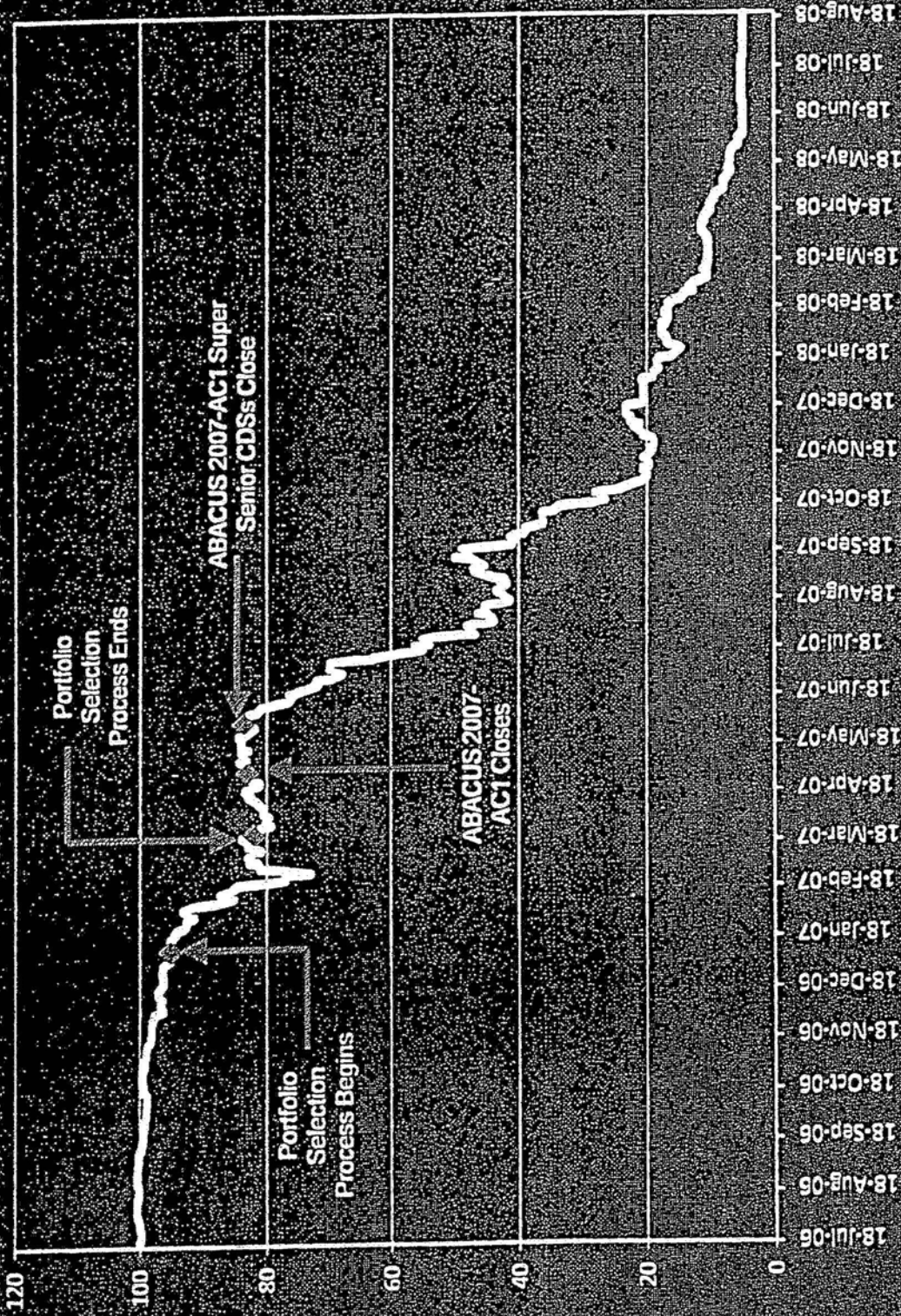
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Price of ABX.HE 06-2 BBB Index Over Time



FOIA Confidential Treatment
Requested by Goldman Sachs

Provided Pursuant to
Fed. R. Evid. 408

Performance of the Reference Portfolio

Data	2007-AC1 Final Reference Portfolio	Initial Portfolio Suggested by ACA	Subprime Deals From 2006/1Q07*
Number of Bonds	90	86	293
Average % 60+ Days Delinquent Loans	46.2	45.9	44.4
Average Cumulative Loss on Loans	13.1	12.5	12.2
Average Borrower FICO Score	629	627	624
Average Loan-to-Value Ratio	80	80	81
Average % Limited Documentation	37	40	33
Average Original Credit Enhancement	4.5	4.6	4.6
Average Weighted Average Loan Age (months)	37	38	38
Average % Written Down	85	80	72
Average Time to Writedown (months)**	0.8	1.4	1.7

* All Subprime RMBS deals from 2006/1Q07 as classified by Loan Performance, with a Moody's rating of Baa2 or S&P rating of BBB, without split ratings.

** Goldman Sachs estimate.

**FOIA CONFIDENTIAL TREATMENT
REQUESTED BY GOLDMAN, SACHS & CO.**

UNITED STATES OF AMERICA

before the

SECURITIES AND EXCHANGE COMMISSION

-----X
In the Matter of ABACUS CDO
-----X

777
File No. HO-10911

SUPPLEMENTAL SUBMISSION ON BEHALF OF GOLDMAN, SACHS & CO.

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UNITED STATES OF AMERICA
before the
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-----X
In the Matter of ABACUS CDO
-----X

File No. HO-10911

SUPPLEMENTAL SUBMISSION ON BEHALF OF GOLDMAN, SACHS & CO.

Goldman, Sachs & Co. ("Goldman Sachs") makes this supplemental submission to respond to certain factual questions posed by the Staff during our September 15, 2009 meeting about the ABACUS 2007-AC1 CDO transaction ("2007-AC1"), as well as to provide additional observations with respect to the Staff's theory as it was explicated during the course of the meeting.¹

¹ This submission is provided solely in connection with the Staff's consideration of possible action against Goldman Sachs, and is made without any admission that the conduct under investigation violated any laws, rules or regulations. Should the Staff decide to make any recommendation that varies in any respect from the issues and positions Goldman Sachs has addressed, we expressly reserve the right to revise this submission in accordance with Rule 5(c) of the Commission's Rules Regarding Information and Other Proceedings, 17 C.F.R. § 202.5(c), and Procedures Relating to the Commencement of Enforcement Proceedings and Termination of Staff Investigations, Nos. 33-5310, 34-9796, 1972 WL 130244, at *1-2 (Sept. 27, 1972). Goldman Sachs also expressly reserves the right to object to the admissibility of this submission and those submitted by any other person in any subsequent proceeding. Finally, Goldman Sachs hereby asserts that this submission constitutes attorney work product and requests that (a) it be treated confidentially and not as a waiver of any privilege or immunity from production, and (b) pursuant to Commission Rule 83, 17 C.F.R. § 200.83, that this

I. FACTUAL QUESTIONS POSED BY THE STAFF

During the September 15, 2009 meeting, the Staff raised the following factual matters, which Goldman Sachs undertook to investigate and address:

1. The Staff inquired whether the 293 Baa2-rated securities from the 2006/2007 vintage included in the chart attached as Appendix 2 to Goldman Sachs' Wells Submission included securities backed by "midprime" as well as subprime loans, and thus whether the performance of all subprime and "midprime" Baa2-rated RMBS differed materially from that of the Reference Portfolio.
2. The Staff also raised the issue whether certain undisclosed criteria — such as average borrower FICO scores and geographical concentration of loans — restricted the ability of ACA Capital Management LLC ("ACA") to include in the Reference Portfolio certain securities from within the category of 2006/2007 Baa2-rated RMBS backed by subprime and "midprime" mortgage loans.
3. The Staff asserted its belief that in transactions marketed as having a portfolio selected by a Portfolio Selection Agent, other market participants had disclosed the participation in the portfolio selection process of a party taking a short position with respect to the portfolio and cited the Auriga CDO, Norma CDO I and Sorrento 2006-1 CDOs as examples.

We address these factual matters in sequence.

A. The 293 Securities Described in Appendix 2 to Goldman Sachs' Initial Submission Included "Midprime" RMBS.

The 293 securities in Goldman Sachs' summary of performance of subprime RMBS in Appendix 2 to Goldman Sachs' Wells Submission included "midprime" RMBS. To gather the information set forth in the column labeled "Subprime Deals From 2006/2007" in Appendix 2, Goldman Sachs compiled data for all securitizations other than those classified as "prime" or "alt-A" by LoanPerformance. The 293 securities thus consisted of "midprime" and

submission not be disclosed in response to any request made under the Freedom of Information Act, 5 U.S.C. § 552.

"subprime" securitizations.² As the Appendix (a copy of which is attached to this submission) illustrates, this universe of Baa2-rated, 2006/2007-vintage mid and subprime RMBS suffered losses that were materially similar to those of the Reference Portfolio, because nearly all mid and subprime RMBS of that rating and vintage – including those initially proposed by ACA without Paulson's involvement – have performed poorly.

B. The Portfolio Selection Criteria Were Fully Disclosed in the Offering Documents.

At our September 15 meeting, the Staff asserted that criteria such as average borrower FICO scores and geographic concentration of loans restricted the ability of ACA to include in the Reference Portfolio certain securities from within the category of 2006/2007 Baa2-rated RMBS backed by subprime and "midprime" mortgage loans.

Based on the record available to Goldman Sachs, the only evidence of criteria in addition to the limitation to 2006/2007 Baa2-rated RMBS backed by sub and midprime mortgage loans are draft engagement letters between Goldman Sachs and Paulson & Co., Inc. ("Paulson"), which contain additional criteria initially discussed by Goldman Sachs and Paulson prior to the

² The term "midprime" is used by Moody's Investor Service, which defines "midprime" RMBS as having a weighted-average borrower FICO score between 625 and 700. "Prime" loans have FICO scores greater than 700. Of the 222 RMBS issued in 2006 and the first quarter of 2007 and characterized as "prime" by LoanPerformance, only two had average borrower FICO scores less than 700, and in these two securities the average borrower FICO score was 699.73 and 696.36, respectively. Alt-A securitizations generally contain loans that do not fully meet the definition of "prime." The Federal Housing Finance Authority defines an "alt-A" loan as "[a] conventional single-family mortgage made to a borrower who typically provides limited income or asset verification or no evidence of an employer. Such loans may have other non-standard underwriting." Federal Housing Finance Authority, Mortgage Market Note 07-1, available at <http://www.fhfa.gov/webfiles/1246/MMNOTE9607.pdf> (last visited Sept. 24, 2009). Of the 634 securitizations issued in 2006 and the first quarter of 2007 and characterized as "alt-A" by LoanPerformance, 111 had average borrower FICO scores of less than 700. The average borrower FICO score among these 111 securities, however, was 690.97.

selection of ACA as Portfolio Selection Agent³ (See GS MBS-E-002755993-2756029.) As Goldman Sachs witnesses testified, however, these criteria were used to guide Goldman Sachs' preliminary search for potential reference securities. (Gerst Tr. 134-36; Tourre Tr. Vol. 1, 47-49.) No formal engagement letter was ever executed, and Goldman Sachs has seen no evidence that the criteria listed in the draft engagement letters were ever conveyed to ACA. (Gerst Tr. 51-53.) Indeed, Mr. Tourre testified that the only criteria conveyed to ACA were that the securities be 2006/2007-vintage, Baa2-rated and backed by sub or midprime loans. (Tourre Tr. Vol. 1, 62.) Further, counsel for Paulson deleted the reference to these criteria in the last draft of the engagement letter. (See GS MBS-E-006121092.) The record available to Goldman Sachs does not indicate that any restrictions were imposed on ACA's selection process other than those set forth in the various term sheets, namely, that the portfolio would be comprised of 2006/2007-vintage, Baa2-rated mid and subprime RMBS.

C. Market Practice Did Not Entail Disclosure of a Short Investor's Participation.

At our meeting, the Staff suggested that at least some market participants disclosed the involvement in the portfolio selection process of third parties that took short positions with respect to the CDO's portfolio and referenced as examples the Auriga, Norma and Sorrento transactions. Respectfully, those examples are readily distinguishable, and we have identified no evidence of any such general market practice.

³ The draft of the Engagement Letter dated January 3, 2007, lists six criteria disclosed in the Term Sheet, plus two additional criteria: (i) the value of collateral in the securitization must exceed \$500 million, and (ii) at least 80% of the collateral should consist of adjustable-rate mortgages. (GS MBS-E-002756016.) The draft also limits the reference securities to those issued after March 1, 2006, while the Term Sheet refers to 2006- and 2007-vintage securities. The Reference Portfolio, however, contained eight securities issued in January and February 2006, one security with less than \$500 million in collateral and 20 securities in which less than 80% of the collateral consisted of adjustable-rate mortgages.

Auriga, unlike 2007-ACI, is an actively-managed CDO transaction without a static Reference Portfolio. (Auriga Offering Circular at 200.) Its collateral manager is 250 Capital LLC, a subsidiary of Merrill Lynch & Co., the underwriter of the transaction. (*Id.* at 197.) At our meeting, the Staff made no reference to particular disclosures used in the Auriga, Norma or Sorrento transactions. Our own examination of the Auriga Offering Circular has revealed no relevant disclosures, but we have excerpted three provisions that the Staff may have had in mind.

First, the Auriga Offering Circular discloses that an "Initial Preferred Securityholder"⁴ may take a position opposite that of the noteholders:

Initial Preferred Securityholder may enter into credit derivative transactions relating to Reference Obligations or Cash Collateral Debt Securities in the Issuer's portfolio. On or after the Closing Date, the Initial Preferred Securityholder may enter into credit derivative transactions relating to Reference Obligations or Cash Collateral Debt Securities in the Issuer's portfolio, under which it takes a short position (for example, by buying protection under a credit default swap relating to such obligation or security) or otherwise hedges certain of the risks to which the Issuer is exposed. The Issuer and Noteholders will not receive the benefit of these transactions by the Initial Preferred Securityholder and, as a result of these transactions, the interests of the Initial Preferred Securityholder may not be consistent with those of Noteholders.

(*Id.* at 55.) Goldman Sachs understands that the Initial Preferred Securityholder was Magnetar Capital LLC ("Magnetar"); but this information is not disclosed in the offering circular.

Goldman Sachs does not know the extent to which Magnetar played a role in the selection of the Auriga portfolio, and this too is not disclosed in the offering circular. In fact, other than listing 18 pages of "eligibility criteria" (*id.* at 143-161), which state in general terms what the portfolio may contain, the Auriga offering circular does not mention the contents of the portfolio at all.

⁴ The "Initial Preferred Securityholder" was the purchaser of the Class H Notes, Class I Notes and the "Preferred Securities," which were the three most subordinate classes of securities issued in the Auriga transaction. (Auriga Offering Circular at 1-3.) These three classes of securities were sold in a separate offering and are not described in detail in the Auriga Offering Circular.

Second, the Auriga Offering Circular discloses that the Credit Default Swap Counterparty, Merrill Lynch International ("MLI"), "is likely to seek to eliminate any credit exposure to the Reference Obligations by entering into back-to-back hedging transactions." (*Id.* at 56.) This disclosure is materially similar to that stated in the 2007-AC1 Offering Circular. (See GS MBS 0000010105 ("The Protection Buyer is not required to have any credit exposure to any Reference Entity or any Reference Obligation."); GS MBS-0000010127 ("[T]he Protection Buyer . . . may hold long or short positions with respect to Reference Obligations . . . and may enter into credit derivative or other derivative transactions with other parties pursuant to which it sells or buys credit protection with respect to one or more related Reference Entities and/or Reference Obligations. . . ."))

Finally, the Auriga Offering Circular discloses that, in its capacity as Credit Default Swap Counterparty, MLI may have conflicts of interest because the terms of the transaction permit it to determine when defaults of the Reference Obligations — events that trigger payment to it under the Credit Default Swap — have occurred:

Conflicts of Interest of Credit Default Swap Counterparty. MLI will, in its role as Credit Default Swap Counterparty for all of the Credit Default Swaps, have the right to make determinations regarding the Reference Obligations (including a decision to give notice that a credit event or "floating amount event" has occurred and require the Issuer to make payments to it). In addition, MLI, as Credit Default Swap Counterparty to the Synthetic Securities, will have sole discretion to determine whether and when to declare a Credit Event and to deliver any notice that a Credit Event or a Floating Amount Event has occurred under a Synthetic Security.

(Auriga Offering Circular at 69.) This disclosure, however, relates not to the selection of the reference securities but to the determination that certain credit events have occurred with respect

to them.⁵ Moreover, Auriga's structure is so radically different from that of 2007-ACI that any attempt to analogize the two transactions would be futile.

The Norma CDO, which also was an actively managed transaction underwritten by Merrill Lynch & Co., contained disclosures that were materially similar to those used in Auriga. (Norma Offering Circular at 56, 67.) We understand that Magnetar was the "Initial Preference Shareholder"⁶ for the Norma transaction, but this information is not disclosed in the offering circular. Similarly, we do not know whether Magnetar played a role in the selection of the Norma portfolio, and this too is not disclosed in the offering circular.⁷

⁵ The 2007-ACI Offering Circular disclosed that Goldman Sachs, as Protection Buyer, would have certain conflicts of interest, including that it might enter into other transactions that have an adverse effect on the reference securities. (GS MBS 0000010126-10127.)

⁶ The "Initial Preference Shareholder" was the purchaser of the Class G Notes, Class H Notes and the "Preference Shares," which were the three most subordinate classes of securities issued by the Norma CDO. (Norma Offering Circular at 1-3.) These three classes of securities were sold in a separate offering and are not described in detail in the Norma Offering Circular.

⁷ The Norma CDO was the subject of a December 27, 2007 Wall Street Journal article entitled "Wall Street Wizardry Amplified Credit Crisis - A CDO Called Norma Left 'Hairball of Risk.'" The article states that Norma was "[c]reated at the behest of an Illinois hedge fund" understood by "people familiar with the matter" to be Magnetar. Carrick Mollenkamp and Serena Ng, *Wall Street Wizardry Amplified Credit Crisis - A CDO Called Norma Left 'Hairball of Risk,'* THE WALL STREET JOURNAL, Dec. 27, 2007, at A1. The article goes on to note that

Most of the collateral was not actual securities, but derivatives linked to triple-A rated mortgage securities. Called credit default swaps, these derivatives worked like insurance policies on subprime residential mortgage-backed securities or on the CDOs that held them. Norma, acting as the insurer, would receive a regular premium payment, which it would pass on to its investors. The buyer of protection, which was initially Merrill Lynch, would receive payouts from Norma if the insured securities were hurt by losses. *It is unclear whether Merrill retained the insurance, or resold it to other investors who were hedging their subprime exposure or betting on a meltdown.*

Id. (emphasis added).

Sorrento was a \$67.4-million bespoke CDO transaction. Goldman Sachs has been unable to locate the offering documents used in the transaction. In any event, the disclosure practices used in a \$67.4-million offering cannot be said to reflect market norms for multi-billion-dollar transactions such as 2007-ACI.

More fundamentally, if it were market practice to disclose reverse inquiries and participation by entities with long or short positions in selecting the reference portfolio, we would have expected to see many examples of that disclosure, because those activities were a regular feature of synthetic CDO transactions. Even the existing record reflects that ACA and IKB themselves offered views on reference portfolios in transactions in which they participated. We have confirmed with outside counsel experienced in the drafting of CDO offering materials that market participants were well aware that participants in CDO transactions routinely provided input on selection of the portfolio securities, and that it was not market practice to disclose their involvement in the portfolio selection process. Goldman Sachs has no doubt that a fully developed record would reflect that both long and short investors often initiated transactions through reverse inquiries, and that they and other potential participants regularly expressed views as to the reference portfolio's composition. Market participants understood that those activities occurred, and in the end all were fully capable of analyzing the resulting portfolio and making their investment decision on the merits of the portfolio.

II. THE OFFERING MATERIALS DISCLOSED ALL MATERIAL FACTS.

The September 15 meeting was very useful in helping us understand the Staff's evolving thinking. We appreciate the Staff's willingness to engage in an open and robust discussion of the issues, and take this occasion to offer several additional observations based on the additional insights gained as to the Staff's theory.

Goldman Sachs had prepared its Wells Submission in response to the proposed charges as outlined in the Staff's Wells call and ensuing letter in early August, which appeared to highlight the role of Paulson, as well as ACA's apparent belief that Paulson was an equity investor. The Staff clarified at the meeting that its theory does not turn on disclosure of Paulson's name or on anything unique to Paulson, but rather rests on the degree of participation by any entity in the selection of a reference portfolio when the offering documents refer to a portfolio selection agent and the entity participating in the selection process intends to take a short position with respect to the reference portfolio. As we understand the Staff's position, participation by that entity in that manner would have qualified the offering materials' statement that ACA was the Portfolio Selection Agent, because that statement implied that the Agent acted without input or comment from others in selecting the portfolio.

With the benefit of this clarification of the Staff's position, we revisit below several points we have previously made to sharpen our observations:

- *First*, investors already understood and therefore required no disclosure that (i) a synthetic CDO transaction could not occur absent market participants absorbing both the long and short side of the exposure, and (ii) it is a regular aspect of the market for those participants to make reverse inquiries about transactions and express their views as to the reference portfolio. The reference to a Portfolio Selection Agent did not suggest otherwise or implicitly disclaim the normal interaction among participants in the transaction, and so needed no qualification as to the degree of investor participation in the process. (Section A)
- *Second*, to the extent that investors took comfort in ACA's role in selecting the Reference Portfolio, they received the benefit of ACA's participation, because in the end the Portfolio was selected by ACA, and no transaction could have occurred absent its approval. There can simply be no question as to ACA's

satisfaction with the Reference Portfolio as it invested its own capital heavily in the transaction. (Section B)

- *Third*, however the Reference Portfolio came to be, the sophisticated institutional investors in the resulting ABACUS private placement were well-equipped to perform their own objective analysis of the underlying assets, which turned on information equally available to all participants. (Section C)

A. All Investors Understood That Synthetic CDO Transactions Emanate From Inquiries by Market Participants and That Those Participants Provide Input Into the Portfolio's Composition.

The Staff's theory hinges on the proposition that investors assumed by virtue of the reference to a Portfolio Selection Agent that the Agent would operate alone and without input from other participants in the transaction, and that the transaction had emanated from Goldman Sachs rather than from a reverse inquiry. Respectfully, the very sophisticated participants involved in 2007-ACI knew differently, and required no disclosure regarding the role of participants taking a short position.

These and other regular CDO investors were fully aware that a synthetic CDO transaction can occur only if there are market participants taking long and short exposure to the reference portfolio. They also understood that synthetic CDOs routinely arose as a result of reverse inquiries; indeed, they had themselves made such inquiries from time to time. For example, IKB's own inquiry led to the initial ABACUS transaction. Finally, they were also fully aware that in synthetic CDO transactions, participants often express their views as to the composition of the portfolio; they had all expressed their views in such circumstances in the past. Accordingly, they had every reason to assume that these same dynamics — participants shorting

the portfolio, reverse inquiries and interactions as to the portfolio composition – would exist in the case of 2007-AC1.⁸

The reference in the offering materials to a Portfolio Selection Agent did not imply otherwise. The Staff expressed the view that such a selection agent presumptively assembles a portfolio without input from investors or reference to selection criteria, but provided no basis in industry practice or otherwise for such a presumption. Certainly there was nothing in the offering materials that so suggested.⁹ All those materials said was that *this* agent would select the ultimate portfolio, subject to disclosed criteria, and even under the Staff's theory there cannot be any question that ACA made the selections. That ACA had input from interested participants does not diminish its exclusive authority to select the portfolio, its thorough review

⁸ Goldman Sachs does not understand the Staff to contend that it should have disclosed the participation of *any* entity that intended to take a short position, no matter how little that entity had participated in the portfolio selection process. Further, customary market practices do not generally have to be disclosed to investors. *See In re Worlds of Wonder Sec. Litig.*, 35 F.3d 1407, 1417-18 (9th Cir. 1994) (common industry practices require no disclosure).

⁹ The offering circular described the role of the Portfolio Selection Agent as follows:

- The Portfolio Selection Agent will, pursuant to the terms of the Portfolio Selection Agreement, (a) select the Initial Reference Portfolio and (b) have the right to review the calculations of the Credit Default Swap Calculation Agent and the Trustee on any Determination Date. The Portfolio Selection Agent will not be responsible for producing or providing reports, notices or other information relating to the Notes or the Reference Portfolio. The Portfolio Selection Agent will not provide any other services to the Issuer or act as the "collateral manager" for the Collateral. The Portfolio Selection Agent will not have any fiduciary duties or other duties to the Issuer or to the holders of the Notes and will not have any ability to direct the Trustee to dispose of any items of Collateral.

(GS MBS 0000010178.) The Portfolio Selection Agreement gave ACA the authority to select the Reference Portfolio, and said nothing about whether ACA would act with or without input from third parties. (See GS MBS-E-0003639016.)

of each security included using its proprietary analytic models, and its complete satisfaction with the resulting portfolio as evidenced by its investment of its own cash in the deal.

We also pause to consider precisely what the additional disclosure advocated by the Staff would say. Based on our discussion at the September 15 meeting, Goldman Sachs understands that the Staff apparently has in mind the addition of a disclosure such as the following:

The Portfolio Selection Agent may, from time to time, receive recommendations as to the content of the Reference Portfolio from third parties, including third parties whose interests are adverse to those of the noteholders. The Portfolio Selection Agent may consider and accept or reject such recommendations, with the result that any or all of the Reference Obligations may have initially been proposed by such third parties, and that Reference Obligations originally proposed for inclusion by the Portfolio Selection Agent may be deleted from the Reference Portfolio. Investors should review the list of Reference Obligations set forth herein and conduct their own investigation and analysis with respect to the creditworthiness of each Reference Obligation.

Such a disclosure would provide a potential investor with no information the investor did not already know, since the dynamics described represented a regular course of dealing in the market. A disclosure more narrowly tailored to the facts of the 2007-AC1 transaction would convey even less. For example, a potential disclosure of the discussions at issue here might read:

The Portfolio Selection Agent has received recommendations as to the content of the Reference portfolio from third parties, including a third party that intends to take a short position with respect to the Reference Portfolio (the "Third Party"). The Third Party initially suggested 123 securities to the Portfolio Selection Agent. The Portfolio Selection Agent evaluated these 123 securities, rejected 68 of these securities, accepted 55 of these securities and proposed an additional 31 securities. The Portfolio Selection Agent later proposed an additional 26 securities. Goldman Sachs requested that two of the proposed securities be rejected, and the Portfolio Selection Agent suggested three replacements. After a meeting between the Portfolio Selection Agent and the Third Party, the Portfolio Selection Agent circulated a spreadsheet of 100 securities, including the securities that the two parties had agreed upon, as well as several additional securities. The Third Party requested removal of eight of these securities and Goldman Sachs requested removal of two other securities. The Third Party then circulated a list of 90 securities. The Portfolio Selection Agent requested removal of 3 securities and proposed 11 alternative securities, 3 of which were agreed upon by the Third

Party. The parties then further discussed the substitution of a handful of securities and settled on the final portfolio.

The bottom line is that no amount of disclosure would change that the very sophisticated investors already knew that some entity or entities by necessity had to take a short position, and that any and all participants – including themselves – might express their views as to the reference portfolio. None of these descriptions contains any concrete, analyzable information that might educate the sophisticated institutional investors that typically purchase synthetic CDOs. Regardless of who selected them, the offering documents for each of the reference securities disclosed detailed information on their underlying assets, as required by Regulation AB. It is this concrete information on the assets – not the economic interest of the entity that selected them – that investors could analyze and use to inform their decisions.¹⁰

B. ACA Selected the Reference Portfolio, and the Offering Documents Properly Described ACA as Portfolio Selection Agent.

The Staff questioned at times during the September 15 meeting whether ACA actually selected the portfolio. The record in this investigation is clear that the overwhelming majority of the securities were identified by ACA. Of the 90 securities in the Reference Portfolio:

- 47 were among the 55 selected by ACA from the 123 securities initially sent to

ACA (see GS MBS 0000010274-10277; GS MBS-E-007988151-007988152).

¹⁰

At the September 15 meeting, the Staff stated that it had asked some market participants whether they would have wanted to know prior to investing in a securitization that a participant in the portfolio selection process intended to take a short position, and that these market participants stated that they would have wanted to know this information. Leaving aside whether these market participants could truly and objectively recall – without hindsight – what they thought was material given the market conditions prevalent in 2006 and early 2007, it is unlikely that an informal survey, without reference to the specific, detailed information provided to investors here, would yield meaningful responses.

- 19 were among the 31 initially recommended by ACA for its first portfolio of 86 securities (*see id.*),
- 21 were initially recommended by ACA later in the process (*see* GS MBS 0000010274-10277; GS MBS-E-003026086; GS MBS-E-003838442-3838443; GS MBS-E-002444961-2444962; GS MBS-E-003740868) and
- 3 were initially recommended by Paulson (*see* GS MBS 0000010274-10277; GS MBS-E-003740868; GS MBS-E-007974382).

The record is equally clear that, regardless of who proposed or commented on any particular security, in the end, ACA carefully analyzed every security, and ACA alone selected the final portfolio and underscored its satisfaction by investing its own money. Only ACA had the authority to select and approve the Reference Portfolio; certainly Paulson had no such authority. If investors took any comfort from ACA's role as Portfolio Selection Agent, they got precisely what they were expecting.

C. Investors Had All the Objective Information They Required to Make an Informed Investment Decision.

As Goldman Sachs noted in its initial Submission, what mattered to investors — particularly the sophisticated institutions that invested here — were the details of the Reference Portfolio. Every investor was simply applying its own broad directional bet on macro-economic and housing trends to a portfolio of securities. That objective portfolio information was entirely static and involved no corporate inside knowledge. Regardless of how the Reference Portfolio was selected, the offering documents comprehensively described each individual asset backing the securities. Nothing about the selection process affected the inherent value or risks of the resulting Reference Portfolio. And nothing stopped any investor from adjusting its risk tolerance to the extent that its economic outlook and view of the housing market changed.

Knowledge that a participant in the portfolio selection process intended to short the portfolio – especially in a synthetic CDO, where there *must always* be participants shorting the portfolio – would not alter the “total mix” of information available, given the extensive, objective disclosures present here. *Basic, Inc. v. Levinson*, 485 U.S. 224, 231-32 (1988).

Regulation AB’s objective disclosure scheme reflects as much, *see, e.g.*, 17 C.F.R. §§ 229.1102, 229.1103, 229.1105, 229.1111, and the Staff has not suggested what – if any – additional analysis a description of the portfolio selection process would have permitted investors to perform on the underlying assets.

III. THERE IS NO BASIS FOR ALLEGING THAT GOLDMAN SACHS ACTED WITH SCIENTER OR INTENDED TO MISLEAD ANYONE.

While the September 15 meeting included a robust discussion of materiality, the issue of scienter was never raised. Although we are therefore hopeful that our Wells submission was sufficient to dispel any continuing consideration of charges requiring scienter, out of an abundance of caution we comment briefly as to this issue as well.

We respectfully believe that the Staff has at most shown that ACA may have been confused about the role of Paulson. But nothing in the record establishes that anyone at

Goldman Sachs intended to mislead ACA, and the drafts of the offering materials Goldman Sachs provided to ACA expressly indicated that the first loss tranche was “N/A,” rather than identifying Paulson as the investor. The notion that ACA was misled into believing that Paulson was an equity investor is in all events difficult to reconcile with the Staff’s theory that Paulson proposed weaker securities to ACA, a trend that would have caused a market participant with ACA’s deep knowledge to question Paulson’s true interest.

Nor is there any basis to suggest that Goldman Sachs would have intentionally jeopardized its own reputation and relationship with established customers and counterparties.

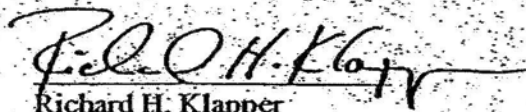
This transaction at the time was just one of many in the marketplace, and because it was a synthetic CDO, Goldman Sachs had no inventory of securities that it would need to dispose of if the transaction did not close, or any other reason to proceed with a transaction that could potentially damage its reputation or relationships. Goldman Sachs had no reason to mislead anyone.

CONCLUSION

For the foregoing reasons, as well as those set forth in the Submission of Goldman, Sachs & Co. dated September 10, 2009, no enforcement action is warranted.

Dated: New York, New York
September 25, 2009

Respectfully submitted,



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Performance of the Reference Portfolio

Data	2007-AC1 Final Reference Portfolio	Initial Portfolio Suggested by ACA	Subprime Deals From 2006/1Q07*
Number of Bonds	90	86	293
Average % 60+ Days Delinquent Loans	46.2	45.9	44.4
Average Cumulative Loss on Loans	13.1	12.5	12.2
Average Borrower FICO Score	629	627	624
Average Loan-to-Value Ratio	80	80	81
Average % Limited Documentation	37	40	33
Average Original Credit Enhancement	4.5	4.6	4.6
Average Weighted Average Loan Age (months)	37	38	38
Average % Written Down	85	80	72
Average Time to Writedown (months)**	0.8	1.4	1.7

* All Subprime RMBS deals from 2006/1Q07 as classified by Loan Performance, with a Moody's rating of Baa2 or S&P rating of BBB, without split ratings.

**Goldman Sachs estimate.

Privileged and Confidential

APPENDIX D

Tourre's Wells Submissions

FOIA CONFIDENTIAL TREATMENT
REQUESTED BY MR. FABRICE TOURRE

UNITED STATES OF AMERICA

before the

SECURITIES AND EXCHANGE COMMISSION

In the Matter of ABACUS CDO

File No. HO-10911

SUBMISSION ON BEHALF OF MR. FABRICE TOURRE

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UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of ABACUS CDO

File No. HO-10911

SUBMISSION ON BEHALF OF MR. FABRICE TOURRE

Mr. Fabrice Tourre makes this submission in response to the Staff's proposed recommendation that an enforcement action be brought against him.¹ No such action is warranted.

PRELIMINARY STATEMENT

For more than a year, the Staff has been investigating the events surrounding the issuance of privately placed notes in a synthetic collateralized debt obligation ("CDO") transaction known as ABACUS 2007-AC1 ("2007-AC1"), which referenced 90 Baa2-rated subprime residential mortgage-backed securities ("RMBS"). Throughout the investigation, the Staff never suggested that it was focusing on the conduct of anyone other than the institutions involved in 2007-AC1. On September 15, 2009, however, the Staff notified counsel for Goldman, Sachs & Co.

¹ This submission is provided solely in connection with the Staff's consideration of possible action against Mr. Tourre, and is made without any admission that the conduct under investigation violated any laws, rules or regulations. Should the Staff decide to make any recommendation that varies in any respect from the issues and positions Mr. Tourre has addressed, we expressly reserve the right to revise this submission in accordance with Rule 5(c) of the Commission's Rules Regarding Information and Other Proceedings, 17 C.F.R. § 202.5(c), and Procedures Relating to the Commencement of Enforcement Proceedings and Termination of Staff Investigations, Nos. 33-5310, 34-9796, 1972 WL 130244, at *1-2 (Sept. 27, 1972). Mr. Tourre also expressly reserves the right to object to the admissibility of this submission and those submitted by any other person in any subsequent proceeding. Finally, Mr. Tourre hereby asserts that this submission constitutes attorney work product and requests that (a) it be treated confidentially and not as a waiver of any privilege or immunity from production, and (b) pursuant to Commission Rule 83, 17 C.F.R. § 200.83, this submission not be disclosed in response to any request made under the Freedom of Information Act, 5 U.S.C. § 552.

("Goldman Sachs") that it would recommend charges against a single individual, Mr. Fabrice Tourre, a French citizen with degrees in engineering and applied mathematics who worked at Goldman Sachs on the 2007-ACI transaction.

In singling out Mr. Tourre among the numerous individuals involved in the 2007-ACI transaction, the Staff relies on the same novel disclosure theory underlying its proposed charges against Goldman Sachs – that the offering materials failed to adequately disclose that Paulson & Co., Inc. ("Paulson"), made suggestions of securities to include in the reference portfolio to ACA Management, LLC ("ACA"), the Portfolio Selection Agent for the transaction. The gist of this proposed charge against Mr. Tourre is that he personally was responsible for the purported disclosure deficiencies in the offering materials.

It would be unfair and unprecedented to bring charges against Mr. Tourre based on the alleged disclosure deficiencies identified by the Staff. Goldman Sachs' Wells submission demonstrates that the relevant offering documents accurately describe the role of ACA in selecting the portfolio. Although Paulson, Goldman Sachs and IKB Deutsche Industriebank AG ("IKB"), which ultimately purchased senior certificates, all made suggestions regarding the content of the reference portfolio, the record establishes that such an interactive process was typical market practice in selecting a CDO reference portfolio; that investors in this market (including IKB) would find such interaction unremarkable and immaterial; and that ACA in all events ultimately chose which securities to include.

Moreover, Mr. Tourre was not the only person with knowledge of Paulson's participation in the portfolio selection process; the details of Paulson's participation were known to each member of Mr. Tourre's trading desk, as well as to ACA and Paulson, neither of which raised any question as to the need to disclose Paulson's involvement in providing input into the

selection of the reference portfolio. Mr. Tourre and his desk were also part of a larger team within Goldman Sachs that included Legal and Compliance personnel who reviewed the 2007-ACI offering documents, as was their customary role. Mr. Tourre -- who is not a lawyer -- could hardly have been expected to identify this normal market practice as raising the novel legal disclosure issue on which the Staff relies, especially given that none of the other sophisticated parties to the transaction, including the experienced lawyers representing Goldman Sachs and ACA, identified this issue either.

Indeed, the disclosure apparently sought by the Staff could very well have been more misleading than enlightening to investors. Mr. Tourre did not know Paulson's overall economic interest or strategic investment plans. Moreover, the incomplete information he did possess was subject to such constant change in a volatile market as to render disclosure of that information highly unreliable.

Nor is there any basis to accuse Mr. Tourre of purposefully or even negligently misleading ACA into believing that Paulson was purchasing equity in the 2007-ACI transaction. The record shows, at most, that despite evidence that the equity was not offered, ACA made an unwarranted assumption that Paulson was purchasing equity in the 2007-ACI transaction. Mr. Tourre never suggested that Paulson was an equity investor, had no duty to correct this mistake, and indeed had an ethical obligation not to disclose the position of Paulson as an investor client. The Staff's suggestion that Mr. Tourre should have corrected any misimpression that ACA had developed based on unwarranted inferences would create an obligation not recognized in existing law.

In short, the Staff's proposed charges are not supported either by the record or by current law, and are particularly unprecedented and unwarranted as applied to Mr. Tourre. If this matter is litigated, Mr. Tourre is confident that a more complete record will further demonstrate that no misrepresentations were made and that Paulson's role was immaterial to investors. He is equally confident that the adjudicating body will conclude that he personally did not violate any law or regulation, or otherwise act inappropriately.

THE RECORD

A. MR. FABRICE TOURRE

Mr. Tourre is a thirty-year-old French citizen, educated as an engineer in Paris and at Stanford University, from which he holds a master's degree in applied mathematics. Upon earning his master's degree in 2001, Mr. Tourre began working at Goldman Sachs in New York structuring credit derivatives, CDOs and asset-backed securities; he currently works at Goldman Sachs International in London as the head of liquidity products trading. (See Transcript of Deposition of Fabrice Tourre on March 3 and 4, 2009 ("Tourre Tr."), Ex. 80.) Mr. Tourre has no formal legal education.

At the time of the events at issue in this investigation, Mr. Tourre was twenty-eight years old and working as part of a trading desk in Goldman Sachs' Mortgage Department. This trading desk consisted of Jonathan Ego (the senior member of the team), Mr. Tourre, David Gerst (a former attorney who worked in a trading function), and Geoff Williams. Although not part of this trading desk, Gail Kreitman (responsible for sales coverage of ACA), Cactus Razzi (responsible for sales coverage of Paulson) and Shin Yukawa (responsible for performing credit rating agency analysis) worked with Mr. Tourre's team on the 2007-ACI transaction. This trading desk formed part of the Structured Products Trading Group within the Mortgage

Department. Also working on the transaction were members of Goldman Sachs' Legal and Compliance departments, which generally had responsibilities for reviewing offering documents to ensure legal compliance. (Tourre Tr. Vol. I 58:16-17.) Mr. Tourre's role within the team, consistent with his expertise in mathematics, was to create and structure credit derivative solutions in order to hedge risk, either for Goldman Sachs or its clients. (Tourre Tr. Vol. I 9:19-10:8.)

B. THE ABACUS TRANSACTIONS

Mr. Tourre was not the architect of the type of CDO structure known as ABACUS, which Goldman Sachs created in 2004. (Tourre Tr. Vol. I 19:3-14.) In the ABACUS structure, a special purpose vehicle ("SPV") sold notes and used the proceeds to purchase collateral securities. The SPV also entered into credit default swap ("CDS") transactions in which it agreed to provide "insurance" payments to a "protection buyer" in the event of write-downs on a portfolio of asset-backed securities (called the "reference portfolio"), in exchange for regular premium payments. (See Submission on Behalf of Goldman, Sachs & Co. dated September 10, 2009 ("Goldman Sachs Initial Submission") at 10.) Thus, in every ABACUS transaction, one or more protection buyers would necessarily hold a short position against the reference portfolio, which could be retained or transferred to another party at any point as the buyer's risk horizon evolved.

The first ABACUS transaction originated from a "reverse inquiry" by IKB, which approached Goldman Sachs with a specific objective to invest in CDO notes of certain ratings that referenced high-grade asset-backed securities. (Tourre Tr. Vol. I 23:24-24:5.) For Goldman Sachs, the ABACUS program initially served to hedge market risk for the Mortgage Department; only in 2005 did it become its own revenue-generating business. (Tourre Tr. Vol. I

20:7-21:6.) In total, Goldman Sachs created and marketed approximately 21 ABACUS transactions during 2004-2007.

At issue in this investigation is the 2007-AC1 transaction, a synthetic CDO referencing a \$2 billion portfolio of 90 Baa2-rated mid- and subprime RMBS. As with prior ABACUS transactions, 2007-AC1 resulted from a reverse inquiry from a Goldman Sachs client, in this instance Paulson, a hedge fund still relatively unknown at the time. (Tourre Tr. Vol. 1 16:23-17:1.) Paulson had inquired whether Goldman Sachs would enter into a CDS with Paulson in which Paulson would buy protection on a portfolio of Baa2-rated RMBS. (Goldman Sachs Initial Submission at 11; Tourre Tr. Vol. 1 16:23-17:1.)

ACA served as Portfolio Selection Agent for 2007-AC1, and received a substantial fee for selecting the portfolio of RMBS to which the CDS entered into by the SPV would refer. As part of this selection process, ACA analyzed and approved each individual security's quality and ability to withstand adverse market conditions. (Tourre Tr. Vol. 1 36:11-19.)

As was the typical market practice, the final portfolio of RMBS referenced in 2007-AC1 was developed through discussions among ACA, Goldman Sachs, Paulson and IKB, with ACA exercising the ultimate authority whether to include any particular security.² The portfolio selection began with Goldman Sachs providing to Paulson a list of RMBS that met Paulson's requirement that the portfolio contain only 2000-vintage subprime RMBS rated Baa2 by Moody's Investor Service and approximately BBB by Standard & Poor's. (Goldman Sachs Initial Submission at 12.) Looking at this list and other RMBS, Paulson selected 123 securities

² Indeed, such an interactive process is necessary in a synthetic CDO transaction in order for the economics of the transaction to be viable: the portfolio in a synthetic CDO transaction must trade at a sufficiently wide spread level and not be overly conservative in order to generate enough spread income in the synthetic RMBS market to attract protection buyers. Without a wide enough spread, the portfolio would not generate enough yield to compensate CDO investors across the capital structure and the transaction would never occur. The input of various interested parties into these transactions helps to ensure a portfolio that is economically viable.

for potential inclusion in the 2007-ACI transaction. (Goldman Sachs Initial Submission at 12; GS MBS-E-007973689.)

Goldman Sachs then sent this list of 123 RMBS to ACA, which evaluated each security using its own proprietary models and rejected 68 of these securities outright (*i.e.*, more than half of the initial list sent by Goldman Sachs). Ms. Laura Schwartz of ACA made clear that ACA rejected the 68 securities based on its own analysis and expertise, noting in an email to Messrs. Toure and Gerst and Ms. Kreitman that ACA had rejected some of the securities because it "did not like them at the recommended attachment point," and others because they were "very susceptible to investor push back." Ms. Schwartz sent back a revised list of 86 RMBS that included 31 new potential reference securities. (GS MBS-E-002537707.) Following these initial communications, ACA, Goldman Sachs and Paulson further refined the portfolio, with all parties suggesting securities for inclusion or deletion. (See Goldman Sachs Initial Submission at 12-13.) Although several parties participated in the portfolio selection process, it cannot be disputed that ACA, as Portfolio Selection Agent, approved all 90 RMBS for inclusion in 2007-ACI and was satisfied with the quality of the reference portfolio. Indeed, Ms. Schwartz made clear that "for us to put our name on something, we have to be sure that it enhances our reputation." (GS MBS-E-007980762.)

The 2007-ACI transaction closed on April 26, 2007. IKB purchased \$150 million in senior certificates, and ACA purchased \$42 million in senior secured notes. Goldman Sachs entered into a CDS with the SPV in a notional amount of \$192 million. In addition,

Goldman Sachs entered into a \$909 million notional amount CDS with ACA referencing the 50-100% tranche of 2007-ACI, with ABN Amro ("ABN") serving as intermediary. Goldman Sachs also entered into CDSs with Paulson in order to sell all of the protection it had purchased.

from the SPV and from ACA (through ABN). Goldman Sachs wrote protection to Paulson on the entire super senior tranche (45-100%), but purchased protection from ACA on only a portion of the super senior tranche (50-100%). As a result, Goldman Sachs bore the market risk on the 45-50% portion of that tranche.³ (See Goldman Sachs Initial Submission at 13-15.)

Due to the widespread deterioration of the housing markets, the value of the subprime loans backing the securities referenced in the 2007-ACI portfolio declined severely. (See Goldman Sachs Initial Submission at 15-16.) Because the reference portfolio for the 2007-ACI transaction was deliberately structured to include only lower-rated (Baa-2) tranches of mid- and subprime RMBS, it was particularly susceptible to the deterioration in the market for subprime loans and suffered a precipitous decline in value starting in June 2007.

C. THE STAFF'S INVESTIGATION

The Staff began its investigation of 2007-ACI in the summer of 2008. Throughout the investigation, the Staff did not suggest that it was focused on any individual, rather than on the institutions involved in the transaction. The Staff took testimony from five Goldman Sachs witnesses, including Mr. Tourre on March 3 and 4, 2009, and Goldman Sachs has produced more than 8,000,000 pages of documents to the Staff. (See Goldman Sachs Initial Submission at 17.) The Staff has also taken testimony from ACA and Paulson witnesses. Until the Staff informed counsel for Goldman Sachs on September 15, 2009, that it planned to recommend charges against Mr. Tourre as an individual, the Staff had not identified any individual as facing potential exposure as a result of its investigation. Indeed, when the Staff made a Wells call to

³ In addition, Goldman Sachs retained the contingent market value risk of the collateral purchased by the SPV issuer. To the extent the CDO tranches on which Goldman Sachs bought protection suffered writedowns, Goldman Sachs would receive loss settlement payments in the form of the Greywolf collateralized loan obligation ("CLO") bond, which was the collateral security held by the SPV. By contrast, Goldman Sachs had to pay Paulson in cash, thereby retaining the risk that if the CDO tranches suffered writedowns, Goldman Sachs would lose the difference between par and the market value of the CLO bond.

Goldman Sachs on July 28, 2009, no mention was made of potential enforcement proceedings against any individual.

The Staff alleges that Mr. Tourre is individually liable under Section 17(a) of the Securities Act of 1933 (the "Securities Act") and Section 10(b) of the Securities Exchange Act of 1934 (the "Exchange Act") and Rule 10b-5 thereunder for two separate acts: (1) failing to disclose in the offering documents that Paulson played a role in selecting the reference portfolio of RMBS, and (2) misleading ACA as to the nature of Paulson's participation in 2007-AC1. If the Staff decides to proceed with its case against Mr. Tourre, it has indicated that it may seek injunctive relief, disgorgement with interest of Mr. Tourre's compensation and bonus attributable to the 2007-AC1 transaction, civil penalties and an industry bar.

DISCUSSION

To prove a violation of Section 17(a)(1) of the Securities Act and Section 10(b) of the Exchange Act, the Staff must establish that Mr. Tourre made a misstatement or omission of a material fact with scienter. *S.E.C. v. Monarch Funding Corp.*, 192 F.3d 295, 308 (2d Cir. 1999). To prove a violation of Sections 17(a)(2) and (3) of the Securities Act, the Staff must show a misstatement or omission of a material fact with negligence. *S.E.C. v. Phan*, 500 F.3d 895, 907-08 (9th Cir. 2007). The alleged omissions or misstatements at issue here were not material. Moreover, the Staff's attempt to hold Mr. Tourre — who is not trained as a lawyer — personally accountable for the alleged misstatements ignores the fact that he was simply one member of a large team that worked on the 2007-AC1 transaction, and was entitled to rely on Goldman Sachs' institutional processes to ensure that disclosures were properly drafted. Finally, Mr. Tourre acted consistently with market practice and industry standards, and there is no

evidence that Mr. Tourre acted with scienter or even negligence. Accordingly, no enforcement action is warranted.

A. THE OFFERING DOCUMENTS CONTAIN NO MATERIAL MISSTATEMENTS OR OMISSIONS

To prove materiality under Sections 17(a) and 10(b), the Staff must show a "substantial likelihood" that a reasonable investor would have viewed the alleged omission or misstatement as significantly altering the "total mix" of information available at the time the investment decision is made. *Basic Inc. v. Levinson*, 485 U.S. 224, 231-32 (1988). In evaluating the materiality of an alleged omission, the offering documents must be read as a whole, focusing on whether the representations, "taken together and in context," would have misled reasonable investors. *DeMaria v. Andersen*, 318 F.3d 170, 180 (2d Cir. 2003) (internal quotation omitted).

The Staff alleges that the offering documents for 2007-AC1 were misleading to investors in failing to disclose Paulson's role in providing input to ACA in the selection of the ultimate reference portfolio. The Staff's apparent belief is that investors would want to know that a party taking a short position on a portfolio also suggested securities for inclusion in that portfolio. The Staff's theory is incorrect for three reasons: (1) the disclosures in the offering documents were accurate, including those regarding ACA's role in making the ultimate selection of the reference portfolio; (2) Paulson's economic interests were not material to investors; and (3) imposing a duty on traders such as Mr. Tourre to disclose the apparent motives of their clients and counterparties would be without precedent and bad policy.

1. ACA is Described Accurately as the Portfolio Selection Agent

The offering documents do not contain any material misrepresentations regarding the selection of the reference portfolio. Each document identifies ACA as the "Portfolio Selection

Agent" or states that the reference portfolio had been "selected" by ACA. (See, e.g., GS MBS-E-002407039; GS MBS-E-003525824; GS MBS 0000010089; GS MBS 0000010096.) These statements are completely accurate: ACA exercised ultimate discretion in selecting the reference portfolio, as is clear from Ms. Schwartz's summary rejection of more than half of the initial reference securities proposed by Goldman Sachs and Paulson. (GS MBS-E-007988151.) Indeed, the record shows that ACA consistently carried out its role in selecting the portfolio and did not hesitate to reject securities it considered unsuitable. (GS MBS-E-002537707; GS MBS-E-002622081.) ACA even invested its own cash in the deal, signifying its complete comfort with the portfolio.

It is also clear that ACA was itself entirely comfortable in disclosing in the offering documents that it selected the reference portfolio, without describing Paulson's role in the process. For example, the Offering Circular provided—in a section prepared by ACA and for which the SPV and Goldman Sachs assumed no responsibility—that ACA would be the portfolio selection agent. (GS MBS 0000010179.) Additionally, ACA's comments to the 2007-ACI termsheet, a document reviewed by ACA's "counsel and business sides," do not discuss Paulson's involvement in the portfolio selection process; indeed, they do not mention Paulson at all. (GS MBS-E-005658291; 5659001.) ACA's comments on the 2007-ACI flip book likewise do not mention Paulson. (GS MBS-E-008032498; 8032521.) Thus, Mr. Tourre and Goldman Sachs were not alone in believing that Paulson's role did not require disclosure: ACA—the party charged with actually selecting the portfolio—was likewise comfortable in not disclosing that Paulson had suggested various RMBS to include in the portfolio.

Moreover, the record is clear that Mr. Tourre did not consider disclosing Paulson's participation in the portfolio selection, or discuss such a disclosure with anyone. (Tourre Tr.

Vol. 1 93:14-24.) And with good reason: portfolio selection for CDO transactions was a dynamic process with input from various interested parties, and no market practice or regulation required disclosure. (See Goldman Sachs Initial Submission at 18-20.) Indeed, the Staff's theory also ignores the fact that another of the ultimate investors in 2007-ACI—IKB—also played a role in portfolio selection. Jörg Zimmerman of IKB repeatedly requested of Mr. Tourre and other Goldman Sachs employees that certain securities be removed from the 2007-ACI reference portfolio. (GS MBS-E-002972269; GS MBS-E-003722826; GS MBS-E-002505288.) These attempts to influence the portfolio selection were apparently IKB's standard practice: on November 23, 2006, Michael Nartey of Goldman Sachs emailed Mr. Tourre's trading desk team that IKB would consider participating in a prior ABACUS transaction (ABACUS 2006-18) "if they could work with us to get a portfolio that worked better by removing some names and maybe adding some new names but would probably only approve AAA and AA investment." (GS MBS-E-007741712.)

The Staff's theory that investors would find it material to know the identities of the parties that had input into the portfolio selection process is out of touch with standard market practice; it certainly is not information that a reasonable investor in this market would believe altered the total mix of available information. Here, both ACA and IKB—the alleged "victims" in this case—were aware that undisclosed parties had provided input into the portfolio selection process and nevertheless made their investments. In the end, what mattered was the portfolio itself, which all potential investors were equally equipped to analyze based on objective valuation tools and their respective perception of macro-economic and housing trends.

2. Paulson's Economic Interests were Immaterial to Investors

Paulson's participation in purchasing credit protection on the reference portfolio is likewise immaterial. Every investor in a synthetic CDO such as 2007-AC1 understood that *some* investor would take a short position on the reference portfolio; this is a basic feature of such transactions. The offering documents plainly disclosed that Goldman Sachs, as Protection Buyer, might continue to hold the short position on the reference portfolio or might enter into derivative transactions in which it would sell credit protection to another buyer. (See Goldman Sachs Initial Submission at 25-27; GS MBS 0000010127.) The fact that it was Paulson that purchased this protection from Goldman Sachs does not change the total mix of information available to investors.

Moreover, the Staff's theory of this case would seem to suggest that Mr. Tourre and Goldman Sachs had a duty to disclose the interests of their clients, in this case Paulson. However, Mr. Tourre, as a trader, had an ethical duty to maintain client confidentiality and avoid disclosing his clients' positions or strategies. *In re Thomas W. Heath, III*, S.E.C. Rel. No. 59223, 2009 WL 56755, at *4 (Jan. 9, 2009) ("The duty to maintain the confidentiality of client information is grounded in fundamental fiduciary principles"). The Staff's theory of this case is squarely in conflict with this duty.

Furthermore, the disclosure of Paulson's underlying interests sought by the Staff would have the potential to mislead investors. Mr. Tourre may have known that Paulson was taking a short position on 2007-AC1 via its CDS with Goldman Sachs (which was confidential information), but Mr. Tourre had only imperfect information about Paulson's overall position or longer-term strategies. Paulson could easily have sold protection on the reference portfolio, just as it bought protection from Goldman Sachs, and Mr. Tourre would have no way of knowing

about that further transaction. Mr. Egol recognized this difficulty of imperfect information in a January 16, 2007, email to Mr. Tourre, stating in reference to Paulson's true motivations: "who knows." (GS MBS-E-002621569.)

Insisting that Goldman Sachs include such a disclosure in the offering documents could well have amounted to a misrepresentation because Paulson's overall position—that is, the sum of its various market strategies—could actually have been a long position. Moreover, information on the market position of a sophisticated entity such as Paulson has an extremely short shelf life; what Mr. Tourre thought he knew about Paulson's position could change at a moment's notice due to market conditions or changes in Paulson's trading strategy or positions that Mr. Tourre would have no way of knowing. The disclosure seemingly desired by the Staff in this case, then, would have been highly susceptible to inaccuracies and would have tremendous potential to mislead investors.

B. CHARGING MR. TOURRE AS AN INDIVIDUAL FOR ALLEGEDLY INADEQUATE LEGAL DISCLOSURES IS UNREASONABLE

The Staff's abrupt shift in its investigation from its focus on institutions to its current allegations against Mr. Tourre completely ignores Mr. Tourre's role within the Goldman Sachs team. As part of this team, Mr. Tourre participated in the 2007-AC1 transaction primarily through communications and meetings with ACA and Paulson, and by drafting the term sheet and flip book, with the help of Mr. Gerst, Mr. Yukawa and Mr. Egol. (Tourre Tr. Vol. 1 56:21-57:5; 58:7-24; 74:1-16.) Indeed, Mr. Tourre did not have exclusive possession of the information regarding Paulson's participation in the 2007-AC1 transaction—every member of his desk was aware of Paulson's role, and apparently it occurred to none of these individuals that this information needed to be disclosed. Moreover, as a French citizen educated in applied

mathematics—and with no formal legal education—Mr. Tourre did not have, and could not be expected to have, the background necessary to identify the novel—and, we strongly assert, incorrect—legal theories on which the Staff now relies.

Indeed, Mr. Tourre testified that Goldman Sachs normally sent its offering documents to outside counsel at McKee Nelson LLP (“McKee Nelson”) for their review (Tourre Tr. Vol. 1 60:19-23), although he could not remember if the 2007-AC1 flip book was sent to McKee Nelson. (Tourre Tr. Vol. 1 60:16-18.) Moreover, McKee Nelson actually drafted most of the offering circular, while Mr. Tourre’s role was limited to reviewing the summary section of that document. (Tourre Tr. Vol. 1 75:16-76:24.) Mr. Tourre also testified that Goldman Sachs’ Legal and Compliance Departments normally reviewed transaction documents, and did so with respect to 2007-AC1. (Tourre Tr. Vol. 1 58:16-17; 59:8-60:1.) Moreover, it was customary practice for Mr. Gerst (who had legal training but was not acting as a lawyer) to review transaction documents. (Tourre Tr. Vol. 1 77:14-17.)

Mr. Tourre reasonably relied on the institutional process set up by Goldman Sachs to ensure adequate legal review and disclosure, and certainly could not be expected to identify the novel legal issues that the Staff now raises. The Staff’s theory that Mr. Tourre is somehow individually responsible for any perceived disclosure deficiencies in the offering documents is unreasonable, unfair and unsupported by the record.

C. THE RECORD SHOWS, AT MOST, AN UNWARRANTED INFERENCE BY ACA REGARDING PAULSON’S PARTICIPATION

The record developed in this year-long investigation shows, at most, that ACA made an unwarranted inference regarding Paulson’s participation in the transaction. The evidence relied on by the Staff shows that Ms. Schwartz of ACA had no reasonable basis to infer that Paulson

was purchasing the equity tranche of 2007-AC1. Moreover, Mr. Tourre was under no duty to correct any alleged misunderstandings by ACA. Finally, the record shows that any mistaken impression ACA held as to Paulson's participation in the transaction was promptly corrected by the transaction offering documents.

The Staff does not allege that Mr. Tourre lied to ACA, or that he affirmatively misrepresented Paulson's economic interest. Instead, the Staff relies on three cryptic emails, taken out of context, to support its allegation that Mr. Tourre misled ACA into believing that Paulson was investing in the equity tranche of the 2007-AC1 transaction: (1) an email dated January 8, 2007, between Ms. Schwartz and Ms. Kreitman, subsequently forwarded to Mr. Tourre, in which Ms. Schwartz states that ACA did not know how Paulson intended to participate in the transaction (GS MBS-E-003499710); (2) an email dated January 10, 2007, in which Mr. Tourre emails Ms. Schwartz various details regarding the 2007-AC1 transaction, including a "Contemplated Capital Structure—subject to Reference Portfolio" that includes a line providing for "[0]%-[9]% pre-committed first loss" (GS MBS-E-003504901); and (3) an email dated January 14, 2007, and subsequently forwarded to Mr. Tourre, in which Ms. Schwartz refers to "Paulson's equity perspective" (GS MBS-E-002480544). Either individually or collectively, these emails demonstrate at most, an unwarranted assumption on the part of ACA, which Mr. Tourre had no duty to correct—and therefore fail to support the Staff's allegations.

It is not surprising that as of January 8, 2007, ACA did not know exactly how Paulson intended to participate in the transaction: the parties were at that time involved in preliminary negotiations regarding the structure of the transaction, the reference portfolio and other key details. Moreover, it was unclear as of this date whether ACA would even be chosen as the

portfolio selection agent: on January 26, 2007, Ms. Schwartz inquired of Mr. Gerst and the rest of the Goldman Sachs trading desk whether ACA would be selected for this transaction. Mr. Tourre responded that, subject to Paulson being comfortable with the portfolio and compensation structure, "it sounds like we will be in a position to engage you on this transaction." (GS-MBS-E-002480674.) The fact that ACA was unsure how Paulson would participate on January 8 merely indicates that the parties had only reached the preliminary stages of the engagement.

Mr. Tourre's January 10, 2007, email referring to the 0-9% tranche as "pre-committed" likewise fails to support the Staff's allegations. Critically, Mr. Tourre's email does not state that it is Paulson that has "pre-committed" to purchase the first loss tranche; the email merely describes this tranche as "pre-committed." It is unclear what this phrase means in this context, and Mr. Tourre testified he did not know what the phrase meant. (Tourre Tr. Vol. 1-145:13-18.) The description of Paulson as the "Transaction Sponsor" in the same email likewise does not support an inference that it is therefore Paulson that had "pre-committed" to purchase the equity tranche, because the word "sponsor" has a variety of different meanings to professionals in the industry. (See Goldman Sachs Initial Submission at 33-34.) Drawing from this email the conclusion that not only was someone purchasing the equity tranche, but that the purchaser was Paulson, amounts at most to a string of inferences on the part of ACA. It is doubtful whether a reasonably prudent securities professional would draw such an inference. See *Gebhart v. S.E.C.*, 255 F. App'x 254, 255 (9th Cir. 2007) ("The objective component of scienter asks what a reasonably prudent securities professional under the circumstances would have done."); Such an email cannot contain a material misstatement, and certainly does not permit an inference that by sending the email Mr. Tourre acted with the intent to deceive Ms. Schwartz.

Moreover, Mr. Tourre's email makes the capital structure, including the "precommitted first loss" line, explicitly contingent on the reference portfolio by describing the "Contemplated Capital Structure" as "subject to [the] Reference Portfolio." (GS MBS-E-003504901.) This disclaimer is further evidence that ACA was unjustified if it assumed that Paulson was definitely investing in the equity tranche.

The final piece of evidence relied on by the Staff is a January 14, 2007, email from Ms. Schwartz to Ms. Kreitman, which was forwarded to Mr. Tourre by Ms. Kreitman on January 16, 2007, in which Ms. Schwartz remarks that the transaction structure is "difficult from a debt investor perspective" but that she can "understand Paulson's equity perspective." (GS MBS-E-002480544.) The Staff charges Mr. Tourre with knowledge of ACA's alleged misunderstanding of Paulson's participation, and his alleged failure to correct that misunderstanding.

The Staff's allegation seeks to impose a duty where there is none. The duty to disclose arises where "one party has information that the other [party] is entitled to know because of a fiduciary or other similar relation of trust and confidence between them." *Chiarella v. U.S.*, 445 U.S. 222, 228 (1980) (internal citation omitted). "In the case of an omission, a duty to disclose arises either (1) through an explicit regulatory or statutory requirement, or (2) when the omitted information is otherwise material." *In re Morgan Stanley and Van Kampen Mut. Fund Sec. Litig.*, No. 03 Civ. 8208, 2006 WL 1008138, at *7 (S.D.N.Y. Apr. 18, 2006) (mem.). The Staff has not alleged any explicit statutory duty to disclose Paulson's position in this transaction, and, as discussed above, Mr. Tourre was under an ethical obligation to refrain from disclosing that position. Mr. Tourre was therefore under no duty to correct any mistaken assumptions made by ACA, even assuming that he read Ms. Schwartz's email and understood that she was under a

misapprehension, which is without support in the record. *See, e.g., Basic Inc.*, 485 U.S. at 239 n.17 ("Silence, absent a duty to disclose, is not misleading under Rule 10b-5."). Further, as discussed above, Paulson's position in the transaction was not material.

Even assuming as true the Staff's allegation that Ms. Schwartz believed Paulson was purchasing the equity tranche, this belief was, or should have been, dispelled by numerous transaction documents.⁴ Indeed, the Staff relies on the "precommitted first loss" line from Mr. Tourre's January 10, 2007, email; yet Mr. Gerst sent to Ms. Schwartz a draft termsheet the *very next day*, January 11, 2007, that indicates that the "Initial Issued Amount" of the first loss tranche is "NA," indicating that this tranche would not be offered. The "Initial Issued Amount" of the Class A, B and C tranches, by contrast, is "[]," indicating that it will be completed with the appropriate number at a later date. (GS MBS-E-002624787-2624788.) This email alone proves that Ms. Schwartz could not reasonably have held the belief that Paulson was investing in the equity tranche.

The record provides many more instances in which Ms. Schwartz and ACA were made aware that no party—let alone Paulson—was investing in the equity tranche. On February 13, 2007, Mr. Gerst emailed Ms. Schwartz, copying Mr. Tourre and others, a draft termsheet that again, provides that the "Initial Issued Amount" of the first loss tranche is "NA," while that amount for tranches A-D is "[]" (GS MBS-E-003825448-3825449.) On February 15, 2007, Ms. Schwartz sent back to Mr. Gerst, copying Mr. Tourre and others, this draft termsheet marked with comments, stating that it had been "reviewed by counsel and business

⁴ Moreover, ACA's purported belief that Paulson was an equity investor would have been neither reasonable nor credible if one accepts the major premise of the Staff's theory that Paulson proposed literally dozens of weaker securities that were systematically rejected by ACA. If this premise were true, then a market participant as sophisticated as ACA would have quickly recognized this trend, and questioned at least in its own mind what Paulson's economic interest was. Certainly, the credibility of ACA's purported interpretation will be subject to vigorous attack in a contested proceeding.

sides." Ms. Schwartz even indicated that she took responsibility for these comments by marking the upper right corner of the document "LS 2/14/07." Again, the "Initial Issued Amount" of the first loss tranche is "NA," while that amount for tranches A-D is "[]" (GS MBS-E-005658991-5658993.)

Furthermore, the offering circular dated April 26, 2007, provides that the "Original Principal Amount" of the first loss tranche is "\$0," while such amount for the A-1 notes is \$50,000,000 and for the A-2 notes is \$142 million. (GS MBS 0000010097.) The "Use of Proceeds" section in this document also provides that the aggregate net proceeds of the offering of the notes will be approximately \$192 million, a figure that represents the \$150 million purchased by IKB and the \$42 million purchased by ACA's affiliate. There is no mention of any proceeds from the sale of the equity tranche, for the simple reason that such tranche was never offered for sale. (GS MBS 0000010098.) Even a cursory glance at the offering circular would have dispelled any belief that Paulson was purchasing equity in 2007-AC1.

ACA was therefore on notice and aware that no party had purchased the equity tranche. This information was disclosed in the offering documents—documents Ms. Schwartz received the very next day after Mr. Tourre's email allegedly misled her. The Staff cannot plausibly allege that any misunderstanding suffered by Ms. Schwartz or ACA reasonably existed after receiving these documents that clearly indicate that no party was purchasing the first loss tranche. *See Schlifke v. Seafirst Corp.*, 866 F.2d 935, 944 (7th Cir. 1989) (holding that written disclosures control over any oral misrepresentations).

**D. THE RECORD DEMONSTRATES THAT MR. TOURRE DID NOT ACT
NEGLIGENTLY OR WITH SCIENTER**

There can be no argument that the amalgamation of cryptic emails and misperceptions by ACA relied on by the Staff establishes any intentional misconduct by Mr. Tourre. Scienter, "a mental state embracing intent to deceive, manipulate or defraud," is the touchstone of a violation under Sections 10(b) and 17(a)(1). *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 n.12 (1976). Some courts have also held that this standard can be met by a showing of "extreme recklessness," defined as an "extreme departure from the standards of ordinary care ... which presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious that the actor must have been aware of it" *S.E.C. v. Steadman*, 967 F.2d 636, 641-42 (D.C. Cir. 1992) (internal citation omitted). In addition,

[t]o prove scienter with respect to a non-disclosure, it is not enough to simply show that the defendant was aware of an undisclosed fact that a court later determines is material. Rather, a plaintiff must show that the defendant must have been aware of both of the materiality of the undisclosed fact and that its non-disclosure would likely mislead investors.

S.E.C. v. Gane, No. 03-61553-CIV-SEITZ, 2005 WL 90154, at *15 (S.D. FL. Jan. 4, 2005)

(internal citations omitted); *see also S.E.C. v. Patty*, 891 F.2d 295, 1989 WL 150064, at *3

(9th Cir. 1989) (mem.) (stating that "[t]he question is not merely whether [the defendant] had knowledge of the undisclosed facts; rather, it is the *danger of misleading buyers* [that] must be actually known or so obvious that any reasonable man should be legally bound as knowing") (internal citation omitted) (emphasis original).

To prove a violation of Sections 17(a)(2) and (3), the Staff must demonstrate negligence, defined as a departure from the standard of reasonable care. *Aaron v. S.E.C.*, 446 U.S. 680, 695-700 (1980). Compliance with industry standards is a factor in determining whether a party met the relevant standard of care in securities cases, though it is not dispositive. *See Vernazza v.*

S.E.C., 327 F.3d 851, 861 (9th Cir. 2003) ("relevant to show the standard of care necessary to a recklessness inquiry"); *Messer v. E.F. Hutton & Co.*, 847 F.2d 673, 679 (11th Cir. 1988) (same); *In re Piper Capital Mgmt., Inc.*, S.E.C. Rel. No. 2163, 2003 WL 22016298, at *8 (Aug. 26, 2003) ("compliance with industry standards is a consideration").

The Staff alleges that Mr. Tourre viewed the CDO and subprime markets as in decline during 2007, and ascribes to this purported view a motivation to lure ACA into the 2007-ACI transaction to make quick profits before the market permanently declined. The Staff has pointed to an email from Mr. Egol to Mr. Tourre on February 11, 2007, in which Mr. Egol states "the cdo biz is dead we don't have a lot of time left" (GS MBS-E-002633997.) The Staff also referenced emails from Mr. Tourre to Ms. Marine Serres on March 1 and 7, 2007, in which Mr. Tourre refers to the "death" of the CDO market (GS MBS-E-006662466) and the "complete explosion" of the subprime market. (GS MBS-E-006666041).

Far from supporting the Staff's theory, the record here refutes it. The email from Mr. Egol of course states the view of Mr. Egol, not necessarily that of Mr. Tourre. The emails to Ms. Serres were sent more than six weeks *after* the emails on which the Staff relies to demonstrate Mr. Tourre's alleged misrepresentations (*see* Discussion, sec. (C) above). The Staff cannot persuasively allege that Mr. Tourre's March 2007 view of the subprime and CDO markets, which were in constant flux during the winter and spring of 2007, influenced his statements to ACA in early January 2007.

Moreover, Mr. Tourre's actions contradict the Staff's theory. If the Staff were correct that Mr. Tourre viewed the subprime market as in permanent decline, he would not have insisted that Goldman Sachs re-offer to Paulson the protection that it purchased from the 2007-ACI SPV. Rather, Mr. Tourre would have sought to retain the protection for Goldman Sachs. That,

however, is not what Mr. Tourre did; instead, he urged that Goldman Sachs re-offer the protection to Paulson. (Tourre Tr. Vol. 1 56:5-9.) Mr. Tourre took this position in contrast with the views of some of his colleagues on his desk who did not want to re-offer the protection, and he engaged in considerable debate on the subject during the time of the 2007-AC1 transaction. (Tourre Tr. Vol. 1 56:8-9.) Under the Staff's theory, Mr. Tourre should have taken the opposite position from the one he urged on his colleagues. He did not do so, and ultimately Goldman Sachs did re-sell the protection to Paulson (and even sold protection on the 45-50% tranche without buying offsetting protection, which caused it to lose money on the 2007-AC1 transaction).⁵

The Staff's theory of scienter therefore fails, based as it is on the statements of others, a re-ordering of the chronology of the pertinent events, and a disregard for the actions taken by Mr. Tourre.

⁵ Indeed, Mr. Tourre's actions and statements on the whole were consistent with his view that the markets were weakening, but that they would ultimately rebound. This view comported with that of some of the market's most sophisticated participants. For example, on February 14, 2007, Alan Greenspan said of the U.S. housing slowdown that "the worst is behind us." (Ex. A.) On March 13, 2007, U.S. Treasury Secretary Henry Paulson said that a decline in U.S. housing activity had damaged subprime markets somewhat, but was not hurting the overall economy. (Ex. B.) And on March 28, 2007, Federal Reserve Chairman Ben Bernanke said in testimony before the Joint Economic Committee of the U.S. Congress that "the impact on the broader economy and financial markets of the problems in the subprime market seems likely to be contained." (Ex. C at 2.)

CONCLUSION

For the foregoing reasons, no enforcement action is warranted.

Dated: New York, New York
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Exhibit A




Greenspan Says Worst of U.S. Housing Slowdown Is Over (Update2)

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By Doug Alexander



Feb. 14 (Bloomberg) — Former Federal Reserve chairman Alan Greenspan said the U.S. housing slowdown may be coming to an end, citing sales of new homes.

"I think the worst is behind us," Greenspan, 80, told a Toronto conference today, during a speech broadcast live via satellite.

"We are in the midst of a very significant inventory liquidation of unsold new homes."

Greenspan's comments represent a view similar to those of his successor, Ben S. Bernanke. Bernanke told the Senate Banking Committee today that the Fed expects economic growth to

strengthen "somewhat as the drag from housing diminishes." Fed policy makers predicted gross domestic product will increase by 2.5 percent to 3 percent this year.

In the statement after the Federal Open Market Committee's most recent meeting on Jan. 31, the Fed said recent data suggest "somewhat firmer economic growth," while the housing market is showing "some tentative signs of stabilization."

Such stabilization is coming after the market's worst slump in 15 years. Sales of previously owned homes are near a three-year low, while housing starts rebounded in November and December from the slowest pace since 2000.

"The worst of the adjustment is over, meaning not that the market is turning," Greenspan said, "but that the rate of decline was at its maximum in the third quarter and continued over in the fourth quarter and should now be moving to a much less negative direction."

Unsold Homes

Inventories of unsold homes are shrinking by about 10,000 to 15,000 units a month, and will soon start to shrink by about 20,000 to 30,000 units a month as housing starts drop, Greenspan said.

"That inventory will continue to liquidate and markets will turn around," he said.

Greenspan also said "disarray" in the U.S. subprime mortgage market, which serves borrowers with weak credit who typically pay higher interest rates, isn't likely to create greater financial instability in the rest of the economy.

"We do have a problem here, it's probably not over," Greenspan said. "It may actually infect some parts of the prime mortgage market, but there's no real evidence that this is a significant issue."

Bernanke said today during his semiannual appearance before the Senate panel that "distress" in the subprime market is of "significant concern" to him, though he didn't yet think it had implications for the larger economy.

'Predatory Lending'

The comments illustrate concern about the subprime market as rising interest rates, looser lending standards and falling home prices put more borrowers at risk of losing their homes. Senate Banking Committee Chairman Christopher Dodd told Bernanke today he's concerned "about the predatory lending practices that go on" in the subprime market.

The mortgage industry has been in turmoil in recent weeks as more homeowners fall behind in their mortgage payments. Subprime mortgages made up about a fifth of all new mortgages in the first half of 2006, according to the Washington-based Mortgage Bankers Association. As of the third quarter, they represented 13.6 percent of outstanding home loans, up from 2.4 percent in 1998.

Since Greenspan retired from the Fed in January 2006, he's been giving paid talks to audiences around the world and is writing a book, "The Age of Turbulence" to be published later this year. He was appointed Fed chairman in 1987 by then-president Ronald Reagan.

To contact the reporter on this story: Doug Alexander in Toronto at dalexander3@bloomberg.net.

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Exhibit B

82-3 777

82-3 777

1. The first part of the document is a letter from the Director of the FBI to the Director of the CIA, dated 10/10/62.

2. The second part of the document is a letter from the Director of the CIA to the Director of the FBI, dated 10/10/62.

3. The third part of the document is a letter from the Director of the FBI to the Director of the CIA, dated 10/10/62.

4. The fourth part of the document is a letter from the Director of the CIA to the Director of the FBI, dated 10/10/62.

5. The fifth part of the document is a letter from the Director of the FBI to the Director of the CIA, dated 10/10/62.



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Housing woes not affecting economy: Paulson

Tue Mar 13, 2007 7:03pm EDT

WASHINGTON (Reuters) - U.S. Treasury Secretary Henry Paulson said on Tuesday a decline in U.S. housing activity has caused some damage in subprime mortgage markets but was not hurting the overall economy.

"I continue to believe the U.S. economy is healthy," Paulson said in an interview on CNBC Television when he was asked about a big drop in the stock market.

"We have had a significant housing correction in the U.S.," Paulson added. "You can't have a correction like that without causing some dislocations. It's too early to tell whether it's bottomed, I believe it has."

The U.S. Treasury chief said it "shouldn't be a surprise to anyone that there's some fallout in the subprime mortgage market ... but it's largely contained."

Paulson said the U.S. economy was "diverse" with growth in exports outstripping imports and consumers still spending.

"Inflation would appear to be contained so again I continue to believe we are making a successful transition from an economy that was growing at an unsustainable rate to one that is growing at a more sustainable rate," Paulson said.

After hosting a day-long session on capital markets and regulation, Paulson avoided a direct answer when asked whether the threat-rampant lawsuits was driving capital away from the United States to other centers.

"We have the best capital markets in the world. They're the most liquid, the most competitive capital markets in the world and they're very important to our economy," he said.

Paulson was interviewed on a day when U.S. stock markets posted their second-worst sell-off of the year.

On another issue, he was asked whether pressuring China to let its yuan currency appreciate risks potential backfire if China comes reluctant to buy U.S. debt securities.

But Paulson, who visited Beijing and Shanghai last week, said China does not yet have a market-determined currency exchange rate and indicated he was not about to back off in demanding that China move toward one.

"They need to show more flexibility," he said.

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Exhibit C

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Statement of
Ben S. Bernanke
Chairman

Board of Governors of the Federal Reserve System

before the

Joint Economic Committee

United States Congress

March 28, 2007

Chairman Schumer, Representative Saxton, and other members of the Committee, thank you for inviting me here this morning to present an update on the outlook for the U.S. economy. I will begin with a discussion of real economic activity and then turn to inflation.

Economic growth in the United States has slowed in recent quarters, reflecting in part the economy's transition from the rapid rate of expansion experienced over the preceding years to a more sustainable pace of growth. Real gross domestic product (GDP) rose at an annual rate of roughly 2 percent in the second half of 2006 and appears to be expanding at a similar rate early this year.

The principal source of the slowdown in economic growth that began last spring has been the substantial correction in the housing market. Following an extended boom in housing, the demand for homes began to weaken in mid-2005. By the middle of 2006, sales of both new and existing homes had fallen about 15 percent below their peak levels. Homebuilders responded to the fall in demand by sharply curtailing construction. Even so, the inventory of unsold homes has risen to levels well above recent historical norms. Because of the decline in housing demand, the pace of house-price appreciation has slowed markedly, with some markets experiencing outright price declines.

The near-term prospects for the housing market remain uncertain. Sales of new and existing homes were about flat, on balance, during the second half of last year. So far this year, sales of existing homes have held up, as have other indicators of demand such as mortgage applications for home purchase, and mortgage rates remain relatively low. However, sales of new homes have fallen, and continuing declines in starts have not yet led to meaningful reductions in the inventory of homes for sale. Even if the demand for housing falls no further,

weakness in residential construction is likely to remain a drag on economic growth for a time as homebuilders try to reduce their inventories of unsold homes to more normal levels.

Developments in subprime mortgage markets raise some additional questions about the housing sector. Delinquency rates on variable-interest-rate loans to subprime borrowers, which account for a bit less than 10 percent of all mortgages outstanding, have climbed sharply in recent months. The flattening in home prices has contributed to the increase in delinquencies by making refinancing more difficult for borrowers with little home equity. In addition, a large increase in early defaults on recently originated subprime variable-rate mortgages casts serious doubt on the adequacy of the underwriting standards for these products, especially those originated over the past year or so. As a result of this deterioration in loan performance, investors have increased their scrutiny of the credit quality of securitized mortgages, and lenders in turn are evidently tightening the terms and standards applied in the subprime mortgage market.

Although the turmoil in the subprime mortgage market has created severe financial problems for many individuals and families, the implications of these developments for the housing market as a whole are less clear. The ongoing tightening of lending standards, although an appropriate market response, will reduce somewhat the effective demand for housing, and foreclosed properties will add to the inventories of unsold homes. At this juncture, however, the impact on the broader economy and financial markets of the problems in the subprime market seems likely to be contained. In particular, mortgages to prime borrowers and fixed-rate mortgages to all classes of borrowers continue to perform well, with low rates of delinquency. We will continue to monitor this situation closely.

Business spending has also slowed recently. Expenditures on capital equipment declined in the fourth quarter of 2006 and early this year. Much of the weakness in recent months has been in types of capital goods used heavily by the construction and motor vehicle industries, but we have seen some softening in the demand for other types of capital goods as well. Although some of this pullback can be explained by the recent moderation in the growth of output, the magnitude of the slowdown has been somewhat greater than would be expected given the normal evolution of the business cycle. In addition, inventory levels in some industries—again, most notably in industries linked to construction and motor vehicle production—rose over the course of last year, leading some firms to cut production to better align inventories with sales. Recent indicators suggest that the inventory adjustment process may have largely run its course in the motor vehicle sector, but remaining imbalances in some other industries may continue to impose some restraint on industrial production for a time.

Despite the recent weak readings, we expect business investment in equipment and software to grow at a moderate pace this year, supported by high rates of profitability, strong business balance sheets, relatively low interest rates and credit spreads, and continued expansion of output and sales. Investment in nonresidential structures (such as office buildings, factories, and retail space) should also continue to expand, although not at the unusually rapid pace of

2006.

Thus far, the weakness in housing and in some parts of manufacturing does not appear to have spilled over to any significant extent to other sectors of the economy. Employment has continued to expand as job losses in manufacturing and residential construction have been more than offset by gains in other sectors, notably health care, leisure and hospitality, and professional and technical services, and unemployment remains low by historical standards. The continuing

increases in employment, together with some pickup in real wages, have helped sustain consumer spending, which increased at a brisk pace during the second half of last year and has continued to be well maintained so far this year. Growth in consumer spending should continue to support the economic expansion in coming quarters. In addition, fiscal policy at both the federal and the state and local levels should impart a small stimulus to economic activity this year.

Outside the United States, economic activity in our major trading partners has continued to grow briskly. The strength of demand abroad has helped to spur strong growth in U.S. real exports, which rose about 9 percent last year, and a robust world economy should continue to provide opportunities for U.S. exporters this year. Growth in U.S. real imports slowed to about 3 percent in 2006, in part reflecting a drop in real terms in imports of crude oil and petroleum products. Despite the improvements in trade performance, the U.S. current account deficit remains large, averaging 6-1/2 percent of nominal GDP during 2006.

Overall, the economy appears likely to continue to expand at a moderate pace over coming quarters. As the inventory of unsold new homes is worked off, the drag from residential investment should wane. Consumer spending appears solid, and business investment seems likely to post moderate gains.

This forecast is subject to a number of risks. To the downside, the correction in the housing market could turn out to be more severe than we currently expect, perhaps exacerbated by problems in the subprime sector. Moreover, we could yet see greater spillover from the weakness in housing to employment and consumer spending than has occurred thus far. The possibility that the recent weakness in business investment will persist is an additional downside risk. To the upside, consumer spending—which has proved quite resilient despite the housing

downturn and increases in energy prices—might continue to grow at a brisk pace, stimulating a more-rapid economic expansion than we currently anticipate.

Let me now turn to the inflation situation. Overall consumer price inflation has come down since last year, primarily as a result of the deceleration of consumers' energy costs. The consumer price index (CPI) increased 2.4 percent over the twelve months ending in February, down from 3.6 percent a year earlier. Core inflation slowed modestly in the second half of last year, but recent readings have been somewhat elevated and the level of core inflation remains uncomfortably high. For example, core CPI inflation over the twelve months ending in February was 2.7 percent, up from 2.1 percent a year earlier. Another measure of core inflation that we monitor closely, based on the price index for personal consumption expenditures excluding food and energy, shows a similar pattern.

Core inflation, which is a better measure of the underlying inflation trend than overall inflation, seems likely to moderate gradually over time. Despite recent increases in the price of crude oil, energy prices are below last year's peak. If energy prices remain near current levels, greater stability in the costs of producing non-energy goods and services will reduce pressure on core inflation over time. Of course, the prices of oil and other commodities are very difficult to predict, and they remain a source of considerable uncertainty in the inflation outlook.

Increases in rents—both market rent and owner's equivalent rent—account for a substantial part of the increase in core inflation over the past year. The acceleration in rents may have resulted in part from a shift in demand toward rental housing as families found homeownership less financially attractive. Rents should begin to decelerate as the demand for owner-occupied housing stabilizes and the supply of rental units increases. However, the extent and timing of that expected slowing is not yet clear.

Another significant factor influencing medium-term trends in inflation is the public's expectations of inflation. These expectations have an important bearing on whether transitory influences on prices, such as changes in energy costs, become embedded in wage and price decisions and so leave a lasting imprint on the rate of inflation. It is encouraging that inflation expectations appear to be contained.

Although core inflation seems likely to moderate gradually over time, the risks to this forecast are to the upside. In particular, upward pressure on inflation could materialize if final demand were to exceed the underlying productive capacity of the economy for a sustained period. The rate of resource utilization is high, as can be seen most clearly in the tightness of the labor market. Indeed, anecdotal reports suggest that businesses are having difficulty recruiting well-qualified workers in a range of occupations. Measures of labor compensation, though still growing at a moderate pace, have shown some signs of acceleration over the past year, likely in part the result of tight labor market conditions.

To be sure, faster growth in nominal labor compensation does not necessarily portend higher inflation. Increases in compensation may be offset by higher labor productivity or absorbed—at least for a time—by a narrowing of firms' profit margins rather than passed on to consumers in the form of higher prices. In these circumstances, gains in nominal compensation would translate into gains in real compensation as well. Underlying productivity trends appear generally favorable, despite the recent slowing in some measures, and the markup of prices over unit labor costs is high by historical standards, so such an outcome is certainly possible. Moreover, if the economy grows at a moderate pace for a time, as seems most likely, pressures on resource utilization should ease.

However, a less benign possibility is that tight product markets might allow firms to pass some or all of their higher labor costs through to prices. In this case, increases in nominal compensation would not translate into increased purchasing power for workers but would add to inflation pressures. Thus, the high level of resource utilization remains an important upside risk to continued progress in reducing inflation.

In regard to monetary policy, the Federal Open Market Committee has left its target for the federal funds rate unchanged, at 5-1/4 percent, since last June. To date, the incoming data have supported the view that the current stance of policy is likely to foster sustainable economic growth and a gradual ebbing in core inflation. Because core inflation is above the levels most conducive to the achievement of sustainable growth and price stability, the Committee indicated in the statement following its recent meeting that its predominant policy concern remains the risk that inflation will fail to moderate as expected. However, the uncertainties around the outlook have increased somewhat in recent weeks. Consequently, the Committee also indicated that future policy decisions will depend on the evolution of the outlook for both inflation and economic growth, as implied by incoming information.

Thank you. I would be happy to take your questions.

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APPENDIX E

Egol's Wells Submissions

FOIA CONFIDENTIAL TREATMENT REQUESTED BY JONATHAN EGOL

UNITED STATES OF AMERICA

before the

SECURITIES AND EXCHANGE COMMISSION

In the Matter of ABACUS CDO

File No. HO-10911

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