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GLOBAL FINANCE

Testimony Sheds Light on SAC's Trading

Former Analyst Says Hedge-Fund Firm Used 'Intelligence Professionals' in Training Sessions; 'Direct Read' or 'Dodgy'

By Christopher M. Matthews

SAC Capital Advisors LP placed such importance on trading information gathered from company executives that it offered sessions led by "intelligence professionals" on how to use meetings to extract clues, jurors were told Wednesday.

The testimony by former SAC analyst Jon Horvath further lifted the veil of secrecy on how the highly successful hedge-fund firm made its trading decisions.

Mr. Horvath is a key witness in the insider-trading case against SAC portfolio manager Michael Steinberg, and his testimony in U.S. District Court in Manhattan underscored the importance SAC put on information directly obtained from companies. He testified that the intelligence training helped him hone his skills on how best to interview and question executives.

He also said Mr. Steinberg and his team of analysts kept internal

Reuters
SAC portfolio manager Michael Steinberg is accused by federal prosecutors of making illegal trades in shares of Dell and Nvidia.

"sizing work sheets" that scored how big a trade should be based on roughly 50 data inputs. Among the data points considered were whether the information was a "direct read" from management and whether management was being "dodgy (avoiding you)."

Either of those inputs could affect the size of a trade, Mr. Horvath told jurors. For example, if management was being "dodgy," it might be a reason to suspect bad news from the company and could cut up to $2 million from a trade, he said.

Prosecutors have accused Mr. Steinberg, 41 years old, of making illegal trades in 2008 and 2009 in shares of **Dell** Inc. and **Nvidia** Corp. They allege he was at the end of a five-person chain that engaged in a broad conspiracy to pass illegal tips on technology stocks, with Mr. Horvath as the link connecting Mr. Steinberg to the conspiracy.

Mr. Steinberg has pleaded not guilty, and his lawyer, Barry Berke, has sought this week to subject Mr. Horvath to intense cross-examination in an effort to undermine his stance as the star witness for the government.

Mr. Horvath is one of six employees from SAC who have pleaded guilty to insider trading. The firm struck a pact in November to resolve criminal insider-trading charges with prosecutors, pleading guilty to insider trading and agreeing to pay about $1.2 billion in penalties.

Steven A. Cohen, SAC's billionaire founder, hasn't been charged criminally. The Securities and Exchange Commission has brought civil charges against him, alleging he failed to adequately supervise traders, including Mr. Steinberg.

On Wednesday, Mr. Horvath detailed how SAC employees were encouraged to feed good trading ideas to Mr. Cohen's portfolio, or book, which was by far the largest at the firm, and discussed the system of performance reviews used at the firm. A spokesman for Mr. Cohen declined to comment.

Mr. Berke asked Mr. Horvath about his 2007 performance review. Mr. Horvath, like other employees, had to score himself on "the frequency and format" of his communications with Mr. Cohen.

Mr. Horvath gave himself a lowly score of 3 on a scale that ranged from 1, consistently exceeding expectations, to 4, consistently missing them. He said Wednesday he gave himself poor reviews across the board and testified earlier that it was his poor performance that led him to pursue inside information.

After what he said was an ultimatum from Mr. Steinberg, Mr. Horvath turned to an analyst friend at hedge fund Diamondback Capital, Jesse Tortora, for confidential information. Mr Tortora has also pleaded guilty to insider-trading charges.

Arrests in Japanese Pension Probe

By Atsuko Fukase

TOKYO—An employee of **Deutsche Bank** AG and a former executive of a pension fund for workers of units of Japanese trading house **Mitsui** & Co. have been arrested over suspicion of bribery, police authorities said Thursday.

Police authorities named the Deutsche Bank employee as Shigeru Echigo, 36 years old, and the former Mitsui employee as Yutaka Tsurisawa, 60.

The Tokyo Metropolitan Police Department said Mr. Tsurisawa, the former Mitsui managing director in charge of handling corporate pension funds, was suspected of accepting entertainment such as dinners and overseas trips valued at an estimated ¥900,000 ($8,973) between April and August last year from Mr. Echigo of Deutsche Bank's securities unit, Deutsche Securities Inc., in return for investing in financial products valued at ¥1 billion.

Messrs. Tsurisawa and Echigo couldn't be reached for comment and it was unclear whether they had legal representation. A spokesman for Deutsche Bank declined to comment on the arrests.

A spokesman for Mitsui & Co. said, "We are sorry that our former employee was involved in this case and after confirming facts, we will consider appropriate action."

The Securities and Exchange Surveillance Commission will ask the financial regulator, the Financial Services Agency, to punish the Frankfurt-based bank for breaching rules on excessive spending to entertain clients as early as later Thursday, people with knowledge of the matter said.

The SESC and the FSA don't comment on individual cases.

Penalties for excessive entertainment spending have been very rare in Japan, as rules on what constitutes "excessive" aren't well-defined, making the job tricky for regulators.

For financial institutions in Japan, taking clients out for dinner and drinks is a regular practice. However, for legal purposes, executives of corporate pension funds who handle portions of the public pension-fund program are covered by antibribery statutes similar to public officals.

Deutsche's pension-fund sales team already has been dissolved, the people familiar with the matter said. According to one person familiar with the situation, employees of Deutsche Securities spent excessively on entertainment such as expensive dinners at Japanese restaurants with three pension funds in return for investments in financial products.

Penalties for excessive entertainment spending are rare.

Regulators have been scrutinizing sales practices in the securities industry since a pension-management scandal last year in which Tokyo money manager AIJ Investment Advisors Co. lost more than $1 billion in client money. Its securities license was later revoked.

Jurors Told of Madoff Tricks

By Ashby Jones

Frank DiPascali Jr., a top operative in Bernard L. Madoff's securities firm, gave jurors a detailed accounting of the inner workings of the firm's massive Ponzi scheme, including a description of how his boss reacted when handed an example of a forged trading report.

"He held the page up to the daylight, 8 inches from the window on the Citibank side of our building," recalled Mr. DiPascali, during testimony Wednesday morning in Manhattan federal court. "He remarked on how great it was."

In his second day of testimony, Mr. DiPascali was questioned at length by a prosecutor on the methods he and others at the firm used to create—and maintain—one of the largest frauds in U.S. history.

Mr. DiPascali, a high-school-educated, Queens, N.Y., native who worked at the firm for more than 30 years, is testifying at the trial of five other former employees who were indicted for their alleged roles in perpetuating an elaborate scam that lasted more than three decades and stole nearly $20 billion from customers.

The five are Daniel Bonventre, Annette Bongiorno, JoAnn Crupi, Jerome O'Hara and George Perez. They all have denied the charges.

Bloomberg News
Frank DiPascali Jr. on Wednesday

Mr. DiPascali, who said he worked closely with the five defendants on trial to produce the fake records, is widely regarded as the government's star witness. The 57-year-old Mr. DiPascali spoke authoritatively on the witness stand Wednesday, through a thick New York accent.

His testimony represents the most detailed depiction of activity within the now-disgraced investment firm and how it deceived customers and regulators.

For instance, Madoff employees went to great lengths to create phony reports from the entity formerly known as Depository Trust Co., often used to hold securities in trust while trades are executed, according to Mr. DiPascali.

He said that for its forgeries the firm used "off the shelf" software, "secured" the proper type of paper and worked hard to replicate the precise fonts that DTC used.

The forgeries, several examples of which were displayed in court, often purported to show that the firm had larger stockholdings than it actually did.

"That entire page is covered with [references to] fake Treasury bills," Mr. DiPascali said, when asked to describe a page of one allegedly forged document.

Mr. DiPascali walked through several documents showing how he and Ms. Crupi created evidence of fake trades relating to accounts held by Stanley Chais, who ran one of Mr. Madoff's larger "feeder funds." The work was tricky, Mr. DiPascali said, because Mr. Chais demanded that he never lose money on any trade. "Were any of the trades on Mr. Chais's account real?" asked prosecutor John Zach. "No," replied Mr. DiPascali.

Mr. DiPascali also was asked about an article in The Wall Street Journal at the time about Avellino & Bienes, an accounting firm that collected funds from its customers and invested the money in Mr. Madoff's scheme.. He said that Mr. Madoff's "biggest concern" about the article related to the ink-dot portrait of Mr. Madoff. Mr. Madoff said it made "his cheeks look too big," according to Mr. DiPascali.

Bloomberg News
Lehman Brothers acquired its stake in the fund firm D.E. Shaw in 2007.

Lehman Looking to Sell Its Stake in Hedge Fund

By Juliet Chung

The estate of Lehman Brothers Holdings Inc. is looking to sell its 20% stake in the **D.E. Shaw Group**, a $33 billion hedge-fund firm in New York.

Six firms have been invited to bid on the stake, according to people with knowledge of the matter. Invitees include the publicly traded asset-management company **Affiliated Managers Group** Inc., which owns stakes in **AQR Capital Management** and **BlueMountain Capital Management**; **Foundation Capital Partners**, a Greenwich, Conn. private-equity firm that has raised money to buy hedge-fund stakes; and private-equity giant **Blackstone Group** LP.

The buyer would assume all the terms Lehman negotiated in 2007, when the bank paid between $750 million and $800 million for its stake.

One person familiar with the matter said he expected the stake could sell for between $650 million and $800 million, with part of the payment potentially being contingent on performance.

The stake doesn't include voting rights, meaning the buyer would share in D.E. Shaw's profits, but wouldn't have a vote in the firm's direction or management.

D.E. Shaw founder David E. Shaw has final approval on the buyer. Mr. Shaw founded the firm in 1988 but has since stepped away from its daily operations. D.E. Shaw is primarily known for its quantitative trading strategies.

Bids are due this month, and two finalists are expected to be selected early next year, when D.E. Shaw will likely open its books for full due diligence. **Goldman Sachs Group** Inc. is running the sale.

The 2007 Lehman acquisition of the D.E. Shaw holding was part of a wave of activity by banks looking to buy their way into the hedge-fund business, either through acquiring firms outright or buying ownership stakes in them.

"It was the jewel of Lehman's nondirect investments in other businesses," said Karl D'Cunha of Chicago-based Madison Street Capital, who specializes in investment banking for asset managers. He said he expects more similar deals in the near future as banks have retreated from owning stakes in hedge funds in light of stricter rules on managing capital and risk.

Lehman, once Wall Street's fourth-largest investment bank, collapsed in September 2008.

The remnants of Lehman Brothers emerged from bankruptcy proceedings last year, and the estate plans to repay creditors $80 billion over time. The estate has estimated unwinding its remaining holdings, which include real-estate investments made via private-equity funds, could take until 2017.

At the time Lehman bought into D.E. Shaw, the hedge-fund firm managed $29 billion and was able to charge management fees of 3% and performance fees of 30% in one of its hedge funds.

—Patrick Fitzgerald contributed to this article

Mounting Tab

Penalties against financial institutions in probes into manipulation of Libor and other market benchmarks

COMPANIES	FINE AMOUNT (■ TOTAL ■ FINED ON WEDNESDAY)	WHO ASSESSED FINES
UBS	$1.52 billion	U.S., Switzerland, U.K.
RBS	$530.6 million / 1.14 billion	U.S., U.K., European Commission
Rabobank	1.07 billion	U.S., the Netherlands, U.K.
Deutsche Bank	983.7 million	European Commission
Société Générale	604.7 million	European Commission
Barclays	453.6 million	U.S., U.K.
J.P. Morgan	108.4 million	European Commission
Citigroup	95.0 million	European Commission
ICAP	87.4 million	U.S., U.K.
RP Martin	0.2 million	European Commission

Sources: EU; the companies

The Wall Street Journal

EU Fines 6 Firms on Rate Rigging

Continued from page C1

gan, for example, said Wednesday that its roughly €80 million settlement regarding manipulation of the Japanese yen version of Libor related to "the conduct of two former traders during a one-month period in early 2007." The New York-based bank is fighting allegations that it was part of a separate cartel involving Euribor.

J.P. Morgan and Citigroup—the latter of which is paying about €70 million to settle the Libor probe—are the first two U.S. banks to be financially penalized for involvement in manipulating benchmark rates. Until now, the absence of any U.S. banks from the punished institutions has been a source of grumbling among senior European finance executives.

The announcement also underscores the widespread nature of the attempted manipulation, involving coordinated campaigns by employees of many of the world's biggest financial institutions to fudge benchmarks that underpin interest rates on everything from mortgages to corporate loans to financial derivatives.

Banks took pains Wednesday to emphasize that the actions were confined to small groups of individuals and didn't involve senior executives. But an EU official involved in the case said that the lack of involvement of senior executives doesn't absolve the banks of responsibility for their employees' behavior.

The previous record in an EU cartel case occurred in December 2012, when the EU fined seven companies a total of €1.5 billion for rigging the market for cathode-ray tubes used to make television and computer monitors.

Three banks that were involved in attempted rate manipulation dodged potentially major penalties by blowing the whistle on their competitors. **Barclays** PLC and **UBS** AG, which paid a total of nearly $2 billion in fines to U.S. and British regulators last year, avoided billions of euros in new penalties, the EU said Wednesday. Citigroup, which was punished in 2011 by Japanese regulators, also won immunity as a whistleblower. Whistleblowers can win immunity in cartel cases or see their fines reduced under EU rules designed to encourage corporate wrongdoers to report collusion.

Like U.S. and British regulators that have punished banks for attempted rate manipulation, the EU based its case in part on electronic communications between traders at various banks. The EU found that traders were regularly in touch with each other trying to move rates up or down, according to a person familiar with the investigation.

"Can you set low as a favour for me?" an unidentified trader wrote to a rival via instant message, according to a transcript reviewed by The Wall Street Journal. The trader added: "I'll return the favour when I can." The trader at the other bank responded, "Just ask."

"What is shocking about the Libor and Euribor scandals is not only the manipulation of benchmarks, which is being tackled by financial regulators world-wide, but also the collusion between banks who are supposed to be competing with each other," Mr. Almunia said.

Germany's Deutsche Bank faced the stiffest fine Wednesday, agreeing to pay a total of about €725 million due to its role in colluding in the setting of both Euribor and the yen Libor.

"Today's settlement marks one important step in our efforts to resolve the bank's legacy issues," the bank's co-chief executives said in a statement. "The settlement relates to past practices of individuals which were in gross violation of Deutsche Bank's values and beliefs."

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