Goldman Cuts Broker Ties Amid Scrutiny Of Customer Interaction

By Liz Moyer, Of DOW JONES NEWSWIRES

NEW YORK -(Dow Jones)- Goldman Sachs Group Inc. (GS) has cut ties with more than a dozen brokers that once steered hedge-fund trades its way amid greater scrutiny of Wall Street's interactions with customers.

Since the beginning of last year, Goldman has cut these broker relationships to roughly six from more than two dozen, people familiar with the matter said. At the same time, Goldman's prime brokerage division has continued to drop smaller fund clients that aren't generating enough profits, people familiar with the matter said, in some cases directing them to the brokers Goldman continues to use.

The moves come amid increased scrutiny. Last week, Goldman Sachs Execution & Clearing LP agreed to pay nearly $10 million to the receiver in a Florida Ponzi scheme that lost $168 million for investors. Goldman hasn't been accused of wrongdoing, but is connected to the case through Shoreline Trading Group LLC, the "introducing" broker for funds run by Arthur Nadel that cleared trades through Goldman.

Nadel's Ponzi came to light in January 2009, after he went on the lam briefly and prompted a manhunt that stretched from Florida to Louisiana. He was sentenced last year to 14 years in prison.

In reaching the settlement, the receiver said Goldman had no knowledge of Nadel's scheme but it may have failed to respond appropriately to "red flags" that, if investigated, could have revealed fraud. Goldman, which said it acted appropriately, cooperated with the receiver and in exchange for settling will be released from further claims.

A federal judge in Florida has to approve the settlement.

Cutting ties to outside brokers "can be seen as part of a derisking occurring at Goldman and elsewhere," said Josh Galper, a managing principal at Finadium, a research and advisory firm to the securities industry.

So-called mid- or mini-prime brokers take on many of the day-to-day aspects of customer service for funds, while the clearing bank handles the execution and settlement of trades and related functions.

The mini-prime industry blossomed in the early part of the last decade, when big banks began cutting smaller funds from their prime brokerage client lists because they weren't profitable enough, creating a demand for firms that could service that market. There has been consolidation among the mini-primes since then.

In culling its list, Goldman is gravitating toward larger firms with greater technology and compliance resources, people familiar with the matter said.

Shoreline no longer introduces clients to Goldman, according to a Financial Industry Regulatory Authority filing. It currently directs trades to J.P. Morgan Chase & Co.'s (JPM) trade clearing arm and to Penson Financial Services Inc., according to its website. A representative of Shoreline couldn't immediately be reached.

Some of the brokers Goldman continues to use are Merlin Securities, Cantor Fitzgerald & Co., and BTIG LLC, an agency brokerage in which Goldman holds a minority stake. Goldman recently broke ties with Cuttone & Co., which is directing accounts to Pershing LLC, and Concept Capital Markets LLC, which continues to clear through JPMorgan, Pershing, and Bank of America's Merrill Lynch, according to its website. Pershing is a division of Bank of New York Mellon Corp. (BK).

Regulators continue to examine how big Wall Street firms interact with smaller clients.

Goldman disclosed earlier this year that its trade-clearing division faces possible civil fraud charges by the Commodity Futures Trading Commission, which says its knew or should have known that a customer was using customer accounts in transactions with Goldman rather than its own. Goldman said it was cooperating.

The bank is also fighting a $20.5 million arbitration award stemming from its role as a clearing broker for the failed hedge fund Bayou Group LLC. Creditors of Bayou have claimed Goldman ignored signs of fraud at the fund run by Samuel Israel III before it imploded in 2005.

A federal court judge affirmed the arbitration award against Goldman last fall. Goldman appealed to the Second Circuit in October.

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