

# Former billionaire hedge fund manager convicted of insider trading

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Wednesday's conviction of former billionaire hedge fund manager Raj Rajaratnam on insider trading charges has been touted by federal prosecutors as a powerful warning to the US financial industry that the government will not tolerate the use of illegal methods to generate fortunes on Wall Street.

Within the financial press, however, the conviction has been the subject of extensive and largely cynical commentary on how it will affect hedge fund trading practices, leading to the use of more elaborate means of concealing the illicit character of trades based on insider information.

Typical was an editorial published in the *Wall Street Journal* Thursday describing the common view of Wall Street as "such a den of thieves that unless you were in on the scam, you were probably one of those being scammed." Comparing the stock market to casino gambling, the column continued, "As they say in Vegas: Look around the poker table. If you can't spot the sucker, it's you."

One thing is certain, the conviction of Rajaratnam did not even begin to touch upon the rampant swindling and criminality that led to the financial crash of September 2008, provoking the deepest economic crisis since the Great Depression and throwing tens of millions of working people out of their jobs and their homes.

Rajaratnam, 53, who headed the Galleon Group hedge fund management firm, was found guilty of reaping illicit profits or avoiding losses that amounted to a total of less than \$64 million, less than a drop in the bucket compared to the trillions upon trillions of dollars in assets wiped out in the financial meltdown of 2008. Government bailouts of the financial institutions responsible for the crisis have transferred these losses onto the public balance sheets, leading to the incessant demands for social cuts to reduce the deficit.

On the eve of his arrest in October 2009, the Sri Lankan-born Rajaratnam was listed as one of the 400 richest individuals in America—and, according to *Forbes* magazine, the 559th wealthiest in the world—with a personal fortune of \$1.8 billion. His Galleon hedge fund managed approximately \$7 billion in assets at its peak.

He now faces a sentence of up to 20 years in prison after being convicted of 14 charges of fraud and conspiracy.

Insider trading is one of the oldest and most common charges

of fraud relating to financial trading. The prohibitions against it date back to the early English and American common law strictures against fraud. The US Supreme Court issued its first ruling on the practice in 1909, sanctioning a corporate director who bought up stock in his publicly traded company based on inside knowledge that the stock price was about to go up.

The Securities and Exchange Act of 1934 tightened prohibitions on insider stock trades and, in 1984, the Supreme Court ruled that anyone trading based on the receipt of inside information is liable if they have reason to believe that the person giving it to them had violated their fiduciary responsibility by making the disclosure.

It is also among the most difficult charges to prove, and therefore insider information has routinely played a major role in the accumulation of ever-greater fortunes by members of America's financial elite.

Rajaratnam was the biggest target in a series of insider-trading prosecutions that have seen 47 individuals indicted over the past year and a half, many of them connected to Galleon's financial activities. Thirty-five have either been convicted or pleaded guilty, many seeking reduced sentences by providing evidence for the federal prosecutors.

Former federal prosecutor Robert Mintz described the prosecution of Rajaratnam as a "landmark case." Its distinction, he told the *Wall Street Journal*, was that this was "the first time prosecutors used wiretap evidence in an insider-trading case."

Indeed, the most compelling evidence against Rajaratnam consisted of some 2,400 secretly recorded phone calls. This is the largest ever use of wiretaps by the federal government in a white-collar crime case. Among them was a tape revealing that he had received confidential information about an anticipated quarterly loss at Goldman Sachs from a member of the finance house's board, Rajat Gupta.

Gupta, who prosecutors said also provided Rajaratnam with prior information of Warren Buffet's planned purchase of \$5 billion in Goldman Sachs preferred stock at the height of the 2008 financial crisis, has faced only securities law charges by the Securities and Exchange Commission (SEC), which he is contesting.

The star witness against Rajaratnam was Anil Kumar, a former executive at the management consulting firm McKinsey

& Company, who pleaded guilty to SEC conspiracy and securities fraud charges and agreed to give evidence in the case as part of a plea deal.

Kumar, who had been close to Rajaratnam since they graduated together from Wharton Business School, testified that he had been paid \$500,000 a year by the hedge fund manager for insider information on mergers and acquisitions involving technology firms. He said the money was funneled into an offshore account set up in the name of his housekeeper. Under the SEC settlement, his sole penalty was paying the agency the \$2.8 million he had received from Rajaratnam over several years.

In a statement following the conviction, the Manhattan US Attorney Preet Bharara said: “Rajaratnam was among the best and the brightest—one of the most educated, successful and privileged professionals in the country. Yet, like so many others recently, he let greed and corruption cause his undoing.”

Or, as the *Wall Street Journal* put it in its editorial Thursday: “The US ... offered the usual denunciation of rampant greed on Wall Street, yadda, yadda.”

Reflecting the prevailing view within the financial oligarchy, the *Journal* regards insider trading rules with barely concealed contempt. “In the real world,” the editorial states, “some investors will learn certain things sooner than others and make shrewder judgments about what they learn.” However, “some investors” are super-rich and connected, while less fortunate “others” often lose pensions or their 401(k)s—that is, their life savings.

The *Journal*’s derisive attitude towards insider trading rules reflects the government’s decision not to go after any of the principal figures on Wall Street involved in the financial criminality that led to the 2008 meltdown.

One of the glaring anomalies of the trial was the prosecution’s calling to the stand of Lloyd Blankfein, the CEO and chairman of Goldman Sachs, who testified that the leaking of confidential information to Rajaratnam violated Goldman’s rules.

“We don’t want information about our company to get out until it’s appropriate,” said Blankfein.

In July of last year, Goldman Sachs was allowed to settle SEC civil charges of “fraudulent misconduct” stemming from Goldman’s issuing of \$2 billion worth of junk securities in the run-up to the financial meltdown. The SEC indictment detailed a conspiracy between Goldman Sachs and hedge fund manager John Paulson to sucker investors into buying into a subprime mortgage-backed collateralized debt obligation (CDO). Paulson then booked profits of \$1 billion by betting on the failure of the CDO’s underlying mortgages, profiting off the losses of Goldman’s investors.

Goldman Sachs was allowed to settle the case, which went to the heart of the devastating crisis that grips the US economy to this day, for just \$550 million, approximately two weeks’ worth of the bank’s annual earnings.

While the tapes presented as evidence against Rajaratnam left little room to argue that he had not engaged in insider trading, the question remains as to why he was subjected to the kind of intense surveillance that previously had been reserved for organized crime or terror suspects.

Federal attention had earlier focused upon the hedge fund manager for matters wholly unrelated to his investment activities. In a criminal complaint filed in the federal court in Brooklyn, New York in 2008 Rajaratnam, a Sri Lankan Tamil, was described as a close collaborator and contributor to a charity that was allegedly used to channel funds to the Liberation Tigers of Tamil Eelam, which Washington had designated as a “foreign terrorist organization.”

While not charged in the case, Rajaratnam was said to have made two donations of \$1 million each to the Tamil Rehabilitation Organization, which billed itself as a charity for ethnic minority Tamils in Sri Lanka. According to federal prosecutors, the donations were passed to another organization, the World Tamil Coordinating Committee, which the government described as a front for the LTTE.

Subsequently, Rajaratnam was sued in federal court in Newark, New Jersey by lawyers claiming to represent victims of LTTE bombings in Sri Lanka, who alleged that he shared responsibility because of his donations.

Given the unprecedented character of the wiretapping mounted against the hedge fund manager, the question arises as to whether he was subjected to covert surveillance earlier based on the case involving the Tamil charity and the LTTE in which warrantless wiretaps could be obtained on the basis of terror allegations.

Rajaratnam was also a major contributor to the Democratic Party, according to filings with the Federal Election Commission. He is listed as giving more than \$87,000 to Barack Obama’s presidential campaign, the Democratic National Committee and the campaigns of Senators Hillary Clinton and Charles Schumer of New York and New Jersey’s Robert Menendez.



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