Galleon Clients Abandon Ship

Two Brokers Drop Fund as Redemption Requests Hit $1 Billion; a Moody’s Mole

BY SUSAN PULLIAM AND GREGORY ZUCKERMAN

Hedge-fund giant Galleon Group, facing heavy investor withdrawal requests after Friday’s arrest of co-founder Raj Rajaratnam, moved to unload some of its technology stocks and other holdings to raise cash.

Investors have sought to withdraw about $1.3 billion of the $3.7 billion in assets Galleon manages, traders say. Moreover, two of the brokerage firms Galleon normally deals with, Bank of America Merrill Lynch and Barclays PLC, have told Galleon they will no longer trade securities positions with the fund firm, according to a person close to the situation.

Both Merrill and Barclays declined to comment, as did Galleon Group.

Inside Galleon, this signaled that some trading partners were pulling back amid worries that Galleon’s assets could be frozen in the pending probe. There was no specific threat that they would be frozen, however, and Galleon deals with about 10 other brokerage firms besides these two. So far, it has had no difficulty selling stocks.

Mr. Rajaratnam told about 130 employees at Galleon’s Manhattan offices Monday that he did nothing wrong. He said he would be “busy” defending criminal charges filed against him as he sits at the center of the biggest insider-trading case in decades. Free on $100 million bail, the 52-year-old Mr. Rajaratnam implored employees, some teary-eyed: “I’m counting on you to take care of our investors. Please turn to page A6

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Clients Abandon Galleon; Redemption Requests Rise

and who passed the information on to Mr. Rajaratnam. The prosecutors said Galleon then reaped $4 million in profit from trading Hilton securities.

The allegation referred to a former Moody's junior analyst named Deep Shah, according to a person familiar with the matter. He hasn't been charged with a crime and it isn't known whether he is under investigation. Mr. Shah couldn't be located for comment. Moody's declined to comment on him.

Traders at Galleon said they believed competitors were seeking to profit from its troubles by selling stocks in the companies that Galleon also holds, believing they will decline as the hedge fund firm sells them.

A blog posting on Friday listed what it said were Galleon's top holdings. The fund's largest, most easily traded stocks, including Apple Inc. and Google Inc., weren't hurt in Monday's rising stock market.

But some Galleon holdings were hit Monday. One was Analogics Inc., a semiconductor company that includes Galleon among its top holders, at 1.2 million shares. At 9:51 a.m., Analogics took a quick 20-cent nose dive, to $4.30 a share, a development some Galleon employees believed was caused by a competitor's attempt to drive down one of the fund firm's stocks. Analogics closed down a little under 2% in an otherwise up day for stocks.

The investor withdrawal requests began pouring in Friday morning, just after news surfaced about Mr. Rajaratnam's arrest, say people within Galleon. Many clients fazed or called the New York firm to formally request withdrawal of their funds.

Most of Galleon's hedge funds allow investors to withdraw money only quarterly, although the technology fund run by Mr. Rajaratnam allows monthly redemptions. There is a 45-day notice period, so Galleon doesn't need to hand back any money until Jan. 1.

Galleon's investors include university endowments, such as Colgate University, and so-called funds-of-funds, which place money in various hedge funds. A spokesman for Colgate said its endowment has invested with Galleon since 2005, but wouldn't comment. One fund-of-funds, Rochdale Investment Management in New York, said Monday it will pull out its $2 million position in Galleon's largest hedge fund.

"We don't conduct business with anyone who in fact violates the law," said Rochdale Chief Executive Garrett D'Alessandro, though he added that he doesn't know whether Mr. Rajaratnam is guilty. Mr. D'Alessandro said the investment represents a "very small" percentage of the Galleon fund and of Rochdale's investments.

Some Galleon investors said that Mr. Rajaratnam was taking their calls Monday and that he remained upbeat. The firm's largest fund has scored gains of about 25% so far this year, one investor said, including small gains this month. That compares with a gain of about 15% for the Dow Jones Industrial Average year to date.

Galleon's chief operating officer, Rick Schutte, directed portfolio managers Monday to shed some positions in a "coordinated, orderly fashion," according to a Galleon trader. The trader said he wasn't told to sell everything but to begin raising some cash.

Galleon has one advantage as it sells holdings: Many are large stocks that can be exited relatively easily in a matter of days without greatly hurting prices. For example, Apple and eBay Inc. were big holdings as of June 30, the latest securities-filing period.

As for rival traders trying to bet against stocks that Galleon holds, a senior Galleon trader noted that the hedge-fund firm does so much trading—1,000 trades a day on average—that rivals wouldn't be able to get a good feel for its current positions. That would make it easier for Galleon to sell positions without disruption. "If people are shooting at positions" held by Galleon as of June 30, "they're shooting at the wrong targets mostly," the Galleon trader said. "They have no clue."

---Serena Ng, Amir Efrati and Joseph Czachor contributed to this article.
Moody's Analysts Are Warned to Keep Secrets

By SERENA NG

From their first day at Moody's Investors Service, junior analysts are warned against sharing confidential information with outsiders. They are even told not to mention company names in the elevators at the credit-rating firm's Lower Manhattan headquarters.

Federal prosecutors now allege that a former junior analyst, identified as Deep Shah, breached that trust in July 2007 when he passed on inside information about Blackstone Group's pending $26 billion takeover of Hilton Hotels.

Mr. Shah and other employees of the ratings firm, owned by publicly traded Moody's Corp., had advance notice about the takeover as part of a standing practice to prebrief credit analysts about planned deals. Prosecutors allege that the junior analyst shared the Hilton information with an unidentified third party, who in turn passed the tip to Galleon Group's Raj Rajaratnam. The tip enabled Mr. Rajaratnam to reap $4 million in profits from trading Hilton shares, a federal complaint alleges.

While Mr. Shah's role in the alleged insider-trading affair is small, his link to the third party—now a key cooperating witness in the probe—could shed light on how investigators uncovered the trading ring. Unusual trading in Hilton's shares was one of the first events that attracted scrutiny from regulators in 2007. The same cooperating witness was friends with an executive at Polycom Inc. and also passed on information about Google Inc.

The complaint said the cooperating witness arranged to pay $10,000 to the Moody's associate analyst, a title that describes staffers who aren't considered full analysts but assist them in analyzing data. Mr. Shah hasn't been charged with a crime. It isn't known if he is under investigation or if he will face charges.

Mr. Shah couldn't be reached for comment. A Moody's spokesman declined to comment on the alleged role of Mr. Shah. He reiterated the company's statement last week, saying that the alleged wrongdoing by one of its employees "would be a egregious violation" of the rating firm's policies.

Moody's has drawn flak in the past year for inaccurate credit ratings on mortgage securities and has had to battle recent accusations from a former employee that it still issues inflated ratings on complex securities. Throughout the financial crisis, however, Moody's credit ratings on corporate bonds have largely conformed to expectations.

Still, critics say the Hilton incident may raise questions about whether rating firms should be privy to inside information. Companies often inform rating analysts about mergers, acquisitions or other transactions ahead of time, to let analysts digest and analyze the information and announce rating actions soon after the deals become public.

Like law firms and investment banks, credit-rating agencies have policies and controls to limit the number of people privy to inside information. "But you can't watch everyone all the time, and if someone is determined to violate the law they will do so," said Scott McCleskey, a former Moody's compliance officer who is now U.S. managing editor of Complant Inc.

Mr. Shah, who is in his mid-20s, left Moody's more than a year ago and is believed to have returned to his home country of India, according to former colleagues. One ex-colleague described him as "mellow."

He joined the ratings firm in an entry-level position, and worked with analysts who rated companies in the technology, lodging and gaming sectors, according to Moody's reports that listed Mr. Shah's name from 2005 to early 2008.

According to the U.S. attorney's complaint, Hilton executives contacted a Moody's lead analyst by phone on the afternoon of July 2, the day before Blackstone Group announced it would acquire Hilton. The complaint said that, shortly afterward, an associate analyst "involved" in the rating called the unidentified third party three times from a cellphone with information that Hilton was to be taken private. The information was passed to Mr. Rajaratnam who traded Hilton's stock, according to the complaint.

As an associate analyst, Mr. Shah would have been paid roughly $90,000 in annual salary, plus a bonus that could reach $30,000, according to former Moody's employees.

—SUSAN PULLIAM contributed to this article.
Insider Case Puts Stocks In Sri Lanka On the Skid

BY ERIC BELLMAN

COLOMBO, Sri Lanka—Raj Rajaratnam, the founder of hedge fund Galleon Group under arrest in New York on charges of insider trading, departed his native Sri Lanka as a child and rarely returned, but his name alone is still enough to move the country’s stock exchange.

While the average Sri Lankan may not recognize his face, the hedge-fund billionaire at the center of what U.S. prosecutors say is the biggest insider-trading case in a generation is the largest individual investor in this small South Asian nation, analysts say. They estimate he has invested more than $150 million in Sri Lankan shares. Even rumors of his trades can send the market up or down.

Fear about the future of his and Galleon’s investments triggered a selloff Monday. After slipping close to 3% during early trading, the Colombo Stock Exchange benchmark All-Share Price Index ended the day at 3082.91, down 1.6%. Shares in which Mr. Rajaratnam or Galleon hold major stakes were among the biggest decliners.

Mr. Rajaratnam and five others were detained and charged in the U.S. on Friday with involvement in a ring that is alleged to have traded on nonpublic information involving International Business Machines Corp., Google Inc. and other big companies. Mr. Rajaratnam’s lawyer, James Walden, has said Mr. Rajaratnam is innocent but couldn’t be reached for comment Monday.

Mr. Rajaratnam, 52 years old, grew up in a respected, middle-class family in Colombo. His father was the chairman of a sewing-machine company, an important post for this garment-exporting nation. Mr. Rajaratnam left Sri Lanka to study at a young age, and after getting a college degree at the University of Sussex in the U.K. and a business degree from the Wharton School at the University of Pennsylvania, he started a career abroad.

While he would make occasional visits to his homeland over the years, it wasn’t until around 2001 that he started diverting slivers of his hedge-fund billions to Sri Lanka, according to friends as well as the executives of companies he has bought into.

With few big companies to invest in—the total value of the stock market here is only around $10 billion—he piled his money into the limited number of large, blue-chip shares. He and his funds quickly became the biggest shareholders in many of Sri Lanka’s top companies.

As of the end of June, analysts estimate, Mr. Rajaratnam and funds associated with him controlled 9% of conglomerate John Keells Holdings PLC, the country’s largest listed company as well as more than 5% stakes in many of the country’s top banks, including Commercial Bank of Ceylon Ltd., National Development Bank Ltd. and DFCC Bank.

Spokesmen at John Keells and DFCC Bank declined to comment on how Mr. Rajaratnam’s case might affect their company’s shares. Representatives for National Development Bank and Commercial Bank of Ceylon couldn’t be reached.

Mr. Rajaratnam’s buy and sell orders were scrutinized every day in the market, so much so that he even complained to one publication that trading was too transparent in Colombo. Some politicians claimed that he used his market power to make the government look bad.

“I tune out these noises and stay focused,” Mr. Rajaratnam told LMD, a local business magazine, in an August interview. “There will always be naysayers and those that want to find sinister motives.”
Scandal Plays Out Among New Power

Billionaire Rajaratnam, Prosecutor Bharara Come From Same Highly Successful Immigrant Group

BY S. Mitra Kalita

It seems like a courtroom drama made for Bollywood: The Sri Lankan hedge-fund kingpin pursued by a fellow immigrant, the Indian-born U.S. attorney for Manhattan.

But the case against Raj Rajaratnam is very much an American story. Mr. Rajaratnam, the billionaire founder of Galleon Group, and Preet Bharara—the Indian-born, Ivy League-educated prosecutor—belong to a relatively small immigrant group who have formed a power elite in the U.S., with positions in corporate boardrooms and a governor's mansion.

An estimated 2.5 million Indians live in the U.S., less than 1% of the total population. But in recent years, South Asians have found disproportionate success in technology and financial services, businesses at the core of the insider-trading allegations unveiled last week.

 Authorities say Mr. Rajaratnam conspired with Intel Capital employee Rajiv Goel and Arul Kumar, a director of McKinsey & Co., global management-consulting firm, between 2006 and 2008. All three received M.B.A. degrees from the Wharton School. All have denied wrongdoing.

Unlike earlier generations of immigrants, the 1965 law opening U.S. borders abolished quotas and favored the brightest and best-educated. That allowed South Asians particularly to penetrate and dominate highly skilled professions, said Ravi Batra, a prominent Indian-American lawyer in New York City.

Mr. Rajaratnam was born and raised in Sri Lanka, an island nation off India's coast and the site of a long-running civil war. He studied engineering at the University of Sussex in England and graduated from Wharton in 1983.

The prosecutor in the case, Mr. Bharara, earned degrees from Harvard University and Columbia Law School. He was born in Ferozepur, India, and arrived in the U.S. as an infant.

The boom in high-technology and financial services lured consultants and investment bankers. Others turned entrepreneurial; one Duke University study found that more than a quarter of all tech start-ups in the U.S. between 1995 and 2005 were initiated by immigrants.

Among the more high-profile in the U.S. are are PepsiCo Inc. Chief Executive Indra Nooyi and Silicon Valley financier Vinod Khosla.

Organizations such as the Indo Entrepreneurs, better known as TIE, often drew venture capitalists and people in private equity and hedge funds. Indian immigrants became known for their ideas and work ethic, said TIE Silicon Valley president Vish Mishra. And many knew one another.

"How do you develop friendships in a new country?" said Mr. Mishra, also the venture director at Clearstone Venture Partners.

"Rajiv Goel was Rajaratnam's college mate. That happens in every society in every community."

For some immigrants, the attraction to hedge funds was logical. Jobs were competitive and lucrative, yet favored the mathematically minded. Compared to the cozy world of investment banking, some South Asians

Examining the Hilton Deal | How information was allegedly used to get ahead of the market

Based on allegations provided in the criminal complaint:

<table>
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<tr>
<th>Monday, July 2, 2009</th>
<th>Tuesday, July 3, 2009</th>
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<tr>
<td>Hilton executives legally and confidentially inform a lead Moody's analyst that Hilton will be acquired by the Blackstone Group.</td>
<td>A Moody's associate analyst tells a cooperating witness that Blackstone will be buying Hilton at a price substantially above its traded stock.</td>
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<tr>
<td>Cooperating witness</td>
<td>The witness tells lead defendant Raj Rajaratnam at Galleon that Hilton is going to be taken private, it's 'a sure thing.'</td>
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<tr>
<td>$35.13</td>
<td>$47.50</td>
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<tr>
<td>Galleon sells Hilton shares for a total profit of about $4 million.</td>
<td>At market's close, Hilton announces it will be acquired by Blackstone for $20.1 billion cash. Blackstone will buy shares outstanding at $47.50, a premium of about $10 per share.</td>
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The cooperating witness arranges to pay the associate Moody's analyst $10,000.

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might have found hedge funds to be more of a meritocracy, according to observers.

Some Indians now fear resentment may spring from the emerging scandal. "A level of success invites a level of scrutiny, that is always a natural consequence of success," said Rajiv Khanna, president of the India-America Chamber of Commerce. "It's not good publicity for the Indian businessman, but does [Bernard] Madoff define all the Jewish businessmen?"

"There've been so many scandals. This is one of several hundred," added Vivek Wadhwa, co-author of the Duke study and also a Harvard researcher who has examined immigrant education and networks.

"All it shows is that Indians are coming of age," he said. "We have our bad apples too."
Inside Plays | Some cases that have shaped thinking on insider-trading law

Mark Cuban
A district court judge in July threw out charges against Mr. Cuban, the owner of the NBA's Dallas Mavericks. Mr. Cuban sold stock in Mamma.com after speaking with its chief executive about a confidential deal that would have devalued the company’s shares. The judge agreed with Mr. Cuban's argument that he was innocent because he never promised not to trade on the information.

Arthur Samberg
The SEC notified the founder of Pequot Capital Management this summer that it intends to file civil charges against him in connection with trading in Microsoft Corp. stock. Pequot said it would vigorously fight any charges. The SEC earlier closed a probe into the matter because of insufficient evidence, but reopened the case after new information emerged.

James McDermott
The former head of Keefe, Bruyette & Woods Inc. settled a 1999 case brought for leaking secrets to his mistress, an adult film actress. Mr. McDermott was the first chief executive of a Wall Street firm to be prosecuted for insider trading, but he never actually benefited from the transactions.

Being Inside Can Have a Downside

By Kara Scannell

Hedge funds scour the landscape for bits of information they hope will give them a trading edge. In the criminal charges filed against the co-founder of Galleon Management LLC and others, authorities are testing whether the line between research and illegal conduct has been crossed.

Merely trading on nonpublic, market-moving information isn’t enough to prosecute someone for insider trading. Authorities must also show that suspects violated a duty to their employer or its shareholders, or had some other obligation not to trade on the private information.

Prosecutors will have a tighter case against Galleon co-founder Raj Rajaratnam if they can prove he traded on corporate secrets that he learned from people he knew had an obligation not to divulge the information.

"Just saying, we want better information, even we want information no one else has, there’s absolutely nothing illegal about that," said Christopher Clark, a former federal prosecutor who is now a defense lawyer. "The only illegality is when it comes in breach of a fiduciary duty or in another similar duty that requires them not to use the information."

Federal prosecutors and the Securities and Exchange Commission last Friday charged six people, including Mr. Rajaratnam, with trading on inside information, netting some $20 million in trading profits. According to the criminal complaint, in one instance, the person who provided the information that Mr. Rajaratnam traded on was paid in cash; and in others, they were given stock tips they could trade on themselves.

The investigation comes as the SEC has been increasing its focus on hedge funds and has ramped up surveillance to look for patterns and trends in trading. Over two years ago, the SEC expanded its focus beyond looking solely at individual stocks that had suspicious trading patterns. The agency put in place a new computer system that looks for traders who pop up repeatedly in insider-trading referrals, people familiar with the matter said.

Hedge funds still generally pose bigger hurdles to prosecution. They often trade in and out of a security multiple times, making it difficult for authorities to prove that insider information motivated a particular trade.

While individual inside traders often make their money from learning inside gossip about a takeover or merger, hedge funds aren’t just interested in such big news. Often they’re looking for pieces of information about a company, such as future earnings or changes in product development, to make a quick profit.

Allegations about improper trading tied to relatively mundane earnings news surfaced in the SEC investigation of Arthur Samberg, founder of Pequot Capital Management. Mr. Samberg has vehemently denied any wrongdoing.

In July, the SEC sent Mr. Samberg and Pequot a Wells notice stating it intends to file civil fraud charges for trading in Microsoft Corp. stock, based on information that Mr. Samberg may have learned from a one-time Microsoft employee ahead of an earnings announcement. No charges have been filed.

In a classic insider-trading case, a corporate insider learns inside information and trades on it. Over the years, legal theories have developed justifying prosecution of other types of traders—even when there’s "not a duty to shareholders of the company whose stock you trade," said Richard Straussberg, a former federal prosecutor who as a defense lawyer has represented clients in insider-trading cases.

All hedge funds registered with the SEC, such as Galleon, and most companies have codes of conduct under which employees pledge not to trade based on inside information. That is one basis for charging a hedge-fund employee with insider trading.

Another is to show that the traders knew the information they received was gained through someone violating a fiduciary duty. Trading based on an overheard conversation in the street generally isn’t criminal, but repeatedly tapping a corporate insider for nonpublic information may be, if it’s clear the insider has a duty not to disclose the information.

What could have tipped the scale in the Galleon case are the recorded conversations picked up through wiretaps the government installed on phones belonging to several defendants. The ability to read the precise words exchanged between Mr. Rajaratnam and his alleged co-conspirators has several elements that could appeal to a jury, former prosecutors say.

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