

# FBI raids 3 hedge funds

News of the insider trading probe prompts fears of wider woes for the financial sector.

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Reporting from New York and Los Angeles — An unfolding federal probe of alleged insider trading on Wall Street is escalating, sending a wave of anxiety over the investment industry.

FBI agents searched the offices of three hedge fund operators Monday, two of which were started by former executives of SAC Capital Advisors, one of the most profitable and secretive hedge fund managers in the country.

One of the firms, Level Global Investors, is partly owned by an arm of Goldman Sachs Group Inc., the most successful and controversial investment bank on Wall Street. The broad insider-trading investigation is also reportedly looking at whether low-level Goldman employees leaked information about pending corporate acquisitions to select clients of the bank.

News of the probe prompted some investors to dump bank and brokerage stocks, fearing a dragnet that could spread misery across the financial sector.

"The market is reacting negatively because it doesn't know where this is going to lead," said Michael Holland, head of money manager Holland & Co. in New York.

"The headlines make it look pretty ugly," he added.

Goldman shares slid 3.4%, Morgan Stanley fell 2.2% and JPMorgan Chase & Co. lost 2.3%.

The federal raids Monday appear to indicate a more straightforward phase of a long-running investigation.

"Now, the government will use fear and negotiation to further their case," said Ron Geffner, a lawyer who represents hedge funds at New York law firm Sadis & Goldberg.

People familiar with the probe have said it could result in arrests by year-end.

A spokesman for Level Global Investors, which is based in Greenwich, Conn., confirmed the FBI's search of its New York office, describing it as "part of what we believe to be a broader investigation of the financial services industry."

The other firms raided were Diamondback Capital Management in Stamford, Conn., and Loch Capital Management in Boston.

Level Global and Diamondback Capital were founded by alumni of Stamford-based SAC Capital.

Level and Diamondback issued statements saying they were cooperating with authorities and were operating as usual.

A lawyer for Loch Capital didn't respond to calls seeking comment.

Hedge funds, which are open only to institutional investors and super-wealthy individuals, use any of a number of often-sophisticated strategies in markets for stocks, bonds and other instruments. They collectively have become one of the biggest generators of wealth in the financial industry, but they largely have escaped the scrutiny and criticism that banks received in the wake of the financial crisis.

The recently enacted federal financial regulatory overhaul imposes few new rules on hedge funds, though it does force most big funds to register with regulators.

A series of recent cases suggest the federal government is fixing its sights on possible insider trading by hedge funds.

Preet Bharara, the U.S. attorney for Manhattan, last month described insider trading as "rampant" and said it was being used to help the wealthiest investors.

"Many of the people who are going to such lengths to obtain inside information for a trading advantage are already among the most advantaged, privileged and wealthy insiders in modern finance," he said in an Oct. 20 speech.

In the biggest case so far, the head of now-defunct Galleon Group hedge funds was accused in October 2009 of reaping \$45 million by relying on inside information to trade tech stocks. He has pleaded not guilty and is awaiting trial. Others in the case have pleaded guilty in agreements with prosecutors.

The current probe appears to be focusing in part on consulting firms that connect their clients — mainly big investors — with experts from various industries.

Last month, the head of one such firm, Broadband Research, sent an e-mail to his clients saying FBI agents had asked him to secretly record meetings with some of them, according to the Wall Street Journal.

This month the SEC sued a French doctor, alleging he provided inside information on drug trials to a hedge fund he had been connected to as a consultant.

Tom Curran, a former prosecutor in New York and now a white-collar defense lawyer at Peckar & Abramson, said it was striking that the government was focusing a criminal probe on a type of research work that has been a hedge fund staple for years.

"This is the way an entire industry operates, and now they're trying to criminalize it," he said.