



Insider Trading: The Galleon Hedge Fund – Anita Raghavan

[00:00:06] Welcome back to the podcast. I'm Alexandra Wrage, and today I'm in very chilly London with business reporter Anita Raghavan. Anita is a New York Times contributor and has previously worked for Forbes and for 17 years at The Wall Street Journal, but today we're going to talk about insider trading and her excellent book, "The Billionaire's Apprentice: The Rise of the Indian-American Elite and The Fall of the Galleon Hedge Fund." It's a great book about disgraced billionaire Raj Rajaratnam. Anita, thank you for joining me.

[00:00:37] Thank you for having me.

[00:00:38] For context, before we start on this story, can you help us understand the nature of insider trading?

[00:00:45] That's a great way to start. As you know, Alexandra, the courts have been tweaking and re-tweaking the legal definition of "insider trading" in recent years, but broadly speaking and from a layman's perspective, insider trading occurs when you have a corporate executive — the tipper, if you will — passing non-public material information, breaching his fiduciary duties to the company he works for and passing that information to a trader, the tippee. The trader acts on that information and, knowing full well that it was improperly obtained, makes a bundle of money. A blatant example of insider trading would be if a trader handed a corporate executive a briefcase full of cash and, in exchange, the corporate executive gave him a tip on the company's earnings or a merger announcement or even a new product. But, unfortunately for prosecutors, insider trading cases don't come so neatly wrapped up.

[00:01:41] Your book makes it very clear that they can be difficult cases to make. Can you tell us the story of Galleon and Raj Rajaratnam at a very broad level?

[00:01:52] At its heart, Galleon is a story about a successful immigrant, Raj Rajaratnam, who came to New York and started a hedge fund called the Galleon Group. Galleon was enormously successful in the late 1990s. In 1999, it returned almost 100 percent in one year. But at some point, probably in the very early days of Galleon's history, Raj started trading on inside information. He would push technology executives — many of the friends that he had met when he was studying at the Wharton School who had now ascended to high positions at technology companies — for corporate secrets, and he would trade on these corporate secrets, making a lot of money for his investors but also catching the eye of regulators. In 2006, the SEC started an investigation into Galleon, and by 2008, the U.S. Attorney's Office in Manhattan joined the investigation. Their efforts culminated in October 2009 with the arrest of Raj Rajaratnam and about five of his informants.

[00:03:05] It's clear in the book that his behavior becomes increasingly brazen over time. Originally, it seems to be tips at social events and then, ultimately, he is paying for information.

[00:03:18] That's right. Ultimately, he is wiring money to the housekeeper of a McKinsey consultant.

[00:03:26] The offshore account of the housekeeper.

[00:03:29] Exactly. It's not briefcases of cash. It's a wire transfer, but there are all these wonderful e-mails as the McKinsey consultant tries to set up an HSBC account for his housekeeper so that she can get the money, or rather he can get the money. In the early days, it was it was much more subtle, but by the end, he's talking openly about it. As Roomy Khan, who was one of Raj's informants, told me, she said, "We always talked about him as the fire hydrant. He was brazen. He had no compunction about telling people that, 'Oh, a Goldman Sachs board member told me this,' or, 'Oh, an Intel executive told me that.'"

[00:04:11] Your book is set in the context of Indian Americans and the community, especially tied to both Wharton and Harvard Business School, in the United States. There are Indian Americans on both sides of this story. It was ultimately prosecuted by Preet Bharara.

[00:04:29] That's right. Raj came to the United States from Sri Lanka in the early '80s to get his MBA, as so many South Asians did at that time. It was at the University of Pennsylvania's Wharton School that Raj actually developed many of his would-be informants, if you will. There were a number of South Asians at Wharton at that time. Raj got to know them. After graduating from Wharton or soon after, he joined Needham & Company, a scrappy investment bank. After a decade there — a very successful decade where he really developed a reputation as a prescient analyst — he was known to do the hard work, but he was also known to push executives on insider tips. He started his own hedge fund, the Galleon Group. In its early years, Galleon struggled a bit, but in 1999, as tech stocks were booming, Galleon had a fabulous year. Raj, who had, through most of the '90s, really been the analyst to these hedge fund honchos — like Stanley Druckenmiller, the protégé of George Soros — suddenly found himself in their ilk. He was playing fantasy football with Paul Tudor Jones. He was a friend of Stanley's. He was catapulted into a realm that I don't think anyone imagined possible.

[00:05:45] What sort of background did he come from? When he left Sri Lanka, was this a life he was already accustomed to?

[00:05:51] He was from an upper-middle class family. His father was a Singer and co-executive of Singer, the sewing machine company, and if you were an executive for a Western company in a country like Sri Lanka in those days, it was quite a prized position to have. He was very different from the other main character in my book, Rajat Gupta, who climbed to be the three-time chairman of McKinsey. Rajat Gupta came from quite humble roots, and he was orphaned by the time he was 18. One of the things that always fascinated me is how the boorish, garrulous, flamboyant Raj Rajaratnam ended up befriending the rather cerebral, well manicured, very well coiffed Rajat Gupta.

[00:06:39] Your book brings that out in a really fascinating way — the different personalities — because in the end, their fates are really linked.

[00:06:46] That's right. I think — and this is where the title of the book for me came from — this idea that, here was Raj Rajaratnam. He was the billionaire. He had more than a billion and a half to his name, and he was the richest South Asian in America. By the time of his arrest, he was actually on the Forbes 400 list of richest Americans. Rajat Gupta had something Raj didn't have: He had this fantastic Rolodex of contacts. He was a regular at Davos. He was the one Indian American who had been invited to White House dinners by both Republican presidents and Democratic presidents. He was an adviser to the Bill

and Melinda Gates Foundation. Yet, he only had a US\$100 million. He didn't have a billion. In the circles that Raj and Rajat traveled in, it was a billion that mattered. I think that's what drew him closer to Raj.

[00:07:34] Tell us that story, about how Raj ultimately seduced Gupta into crossing over the line.

[00:07:43] I think one of Raj's great strengths was that he knew how to play people. Gupta may have had the intellectual textbook smarts, but Raj had the people smarts, and Raj drip-seduced at Gupta, if you will. It started in 2001 when he contributed about a million dollars to this charity that Rajat was trying to raise money for, and he was really struggling. Over time, Rajat started solemnly taking notice of Raj Rajaratnam, this very portly, brazen hedge fund trader. I think it was just a very slow seduction, and I think that Rajat, through much of the time, didn't even admit to himself that he was crossing the line. I suspect that Raj said something like, "That's what all the big wigs do. They sit in these board meetings, and then they come out of them, and they call their friends." Raj just made it seem very acceptable to Gupta.

[00:08:52] You call it a "drip process," and it certainly comes across that way from the book, initially flattering him and saying, "You can provide me market insight, nothing inappropriate," and then it escalates from there. But for people who have not yet had a chance to read the book, what was the core of the crime between these two men?

[00:09:14] The centerpiece of the government's case was a trade that Raj Rajaratnam made at the peak of the financial crisis in Goldman Sachs stock. Prosecutors allege that Rajat Gupta, who was a Goldman director at this time, attended via conference call a Goldman board meeting on September 23, 2008, where the Goldman board was deciding whether to accept a US\$5 billion dollar investment from Warren Buffett. You can imagine: It's the peak of the financial crisis. It's eight days after Lehman has collapsed, and the markets are terribly skittish. News that Warren Buffett was investing in Goldman Sachs was going to send Goldman's shares higher and, no doubt, stabilize the entire stock market. The prosecutors allege that a minute after Gupta got off this call, he phones Rajaratnam. We don't know what the two said to each other, but they spoke for about 30 seconds. What we do know is that Raj summons in one of his executives and says, "Buy Goldman Sachs. Buy Goldman Sachs." There's about four minutes left of trading, and in those four minutes, Raj manages to buy more than US\$25 million of Goldman Sachs stock for the Galleon portfolios and, the next day, obviously makes a huge amount of money on the trade as Goldman Sachs stock soars on the Buffett news.

[00:10:40] That was the core of the government's case, but there had been a number of smaller incidents leading up to that that had enabled the government to use some traditional law enforcement tactics — wiretaps and listening in on the conversations — but one of the things your book really demonstrates, again, is how difficult it can be to prove the communication, even with the resources they were bringing to bear in this case. Why was it that they were successful in this case?

[00:11:12] I think, in large part, they were successful because of the wiretaps. It was the first time that wiretaps had been used in white collar crime and, as you know, wiretaps are often used in prosecuting drug cases, in terrorism cases, but hardly ever in white collar crime. They were also successful because they had a key cooperator. There's this delicious character in the book. Her name is Roomy Khan, and she always seems to be getting into trouble. In the late 1990s, she gets fired from Intel because she is caught on camera faxing confidential financial information to Raj Rajaratnam. Most people would learn their lesson after an incident like that, but Roomy — we visit her in 2005 when her marriage is in tatters. She's swimming under a ton of debt.

[00:12:05] She led a very expensive lifestyle.

[00:12:07] She was extravagant. She was extravagant. She plunked down US\$10 million for a home in Atherton, all cash. In 2005, as she's struggling to get above all of this, she picks up the phone and calls Raj Rajaratnam. Remember, just seven years earlier, she had gotten in trouble for faxing confidential financial data.

[00:12:30] On camera.

[00:12:31] On camera, about Intel to him. She does it again, and the feds were able to use the fact that she had been caught in this crime earlier and use that as a cudgel to get her to cooperate and start making taped phone calls to Raj Rajaratnam, and with the help of these phone calls, they were then able to go to a federal judge and get the wiretaps.

[00:12:56] She was clearly critical to the case, but one of the things that Rajaratnam said afterwards — quite publicly — was that he expressed real disdain for the Indian American community for being so cooperative with the U.S. government. Was that surprising to you? It was a community that he was really embedded in. He was pretty caustic.

[00:13:18] Yes, that's right. That's right. I think he said that all the Caucasians stood their ground, and all the Indians gave him up. What he was talking about there is, when the feds finally unveil their case in 2009, they were very quickly able to get the key Indians who weren't implicated in the case, Anil Kumar and Rajiv Goel, to cooperate and turn state's witness. Whereas Danielle Chiesi, who was also an instrumental player in this case — a former beauty queen turned stock analyst — she never cooperated with the feds and stood her ground and was sentenced to prison, ultimately. I think one of the reasons Raj was so angry at the Indian American community is because, had you not had the testimony of Anil Kumar — who was the McKinsey consultant who had fed him information about the advanced micro-devices takeover of ATI technologies — if you would not have that testimony, and if you would not have had the testimony of Rajiv Goel, who had given him information on Intel, there are real questions about whether the government could have succeeded in securing a conviction of Raj.

[00:14:25] I'm curious about the reputation of somebody like Raj who, of course, is Sri Lankan rather than Indian, and Gupta had been an incredible philanthropist back in Southeast Asia.

[00:14:36] And in the United States.

[00:14:37] But I'm curious about their reputation at home.

[00:14:39] Sure. I think one of the wonderful things for them is that their reputation at home has not been hurt by this case. Indian Americans, both in the United States and Indians back in India, still hold Rajat Gupta in high regard. It may say something about the way Indians view white collar crime. There is a sense that, "What did he really do that was wrong?" A lot of people view insider trading as a victimless crime. I think, if anything, his decision to not cooperate and to stand firm may have actually enhanced his reputation amongst Indians, not just in India but the world over.

[00:15:24] We shouldn't lump the two together. Gupta had, I think, it was 400 letters—

[00:15:30] 800.

[00:15:31] 800 letters of personal recommendation from incredibly lofty citizens talking about his very sincere commitment to philanthropy, to all that he had done for the community both in the United States and in India. That clearly had an impact on his sentencing. Can you talk a little bit about the trial?

[00:15:53] I think, certainly, Gupta was very well regarded both by the highest echelons of society. People like Kofi Annan wrote letters on his behalf at sentencing. But you also saw a number of letters from housekeepers and landscape artists who spoke of Gupta being genuinely a nice guy. I do think that had an impact at sentencing, but I also think it's important to point out that Judge Rakoff did consider Gupta's crimes to be quite serious because Raj Rajaratnam fulfilled his duties to his investors. He fulfilled all his obligations. Nobody lost money in Galleon à la Madoff. Rajat Gupta violated his obligations to Goldman Sachs and to Procter & Gamble, and Judge Rakoff made a point of this during sentencing. While I think it's true Gupta had had a life of accomplishment, of philanthropy that certainly benefited him at sentencing, ultimately, in a way, his crime was greater.

[00:17:03] It's really interesting. They were both equally culpable in the insider trading, but Gupta — although an upstanding citizen in so many other ways — was guilty of a breach of trust in a way that Rajaratnam wasn't.

[00:17:18] That's right because your sole obligation as a board member to a company is to keep the company's confidence, to keep its secrets. Rajat Gupta violated that tenet, and I think that is one of the reasons — since he's gotten out of jail, he's tried to phone a lot of his old friends from the corporate elite. I think he's gotten a frosty reception in the United States because he broke that fundamental principle that you keep company secrets.

[00:17:51] That's a very difficult crime to recover from reputationally. I can't imagine that he thinks he's going to break back into the business community at this point.

[00:18:02] I think he now realizes he's not going to, but I think there was a time he thought some of his old friends — remember one of the people who got him on the board of Goldman Sachs was Hank Paulson, the former treasury secretary. He was very close to the former Sara Lee chairman, and I think he thought a lot of these people would come back and befriend him again. He didn't realize that, once you commit a crime like this, there's no going back.

[00:18:30] I don't even know how you could involve him in business again without violating your own fiduciary duty by selecting somebody who is a felon. He spent two years in prison in the end?

[00:18:39] That's right, yeah.

[00:18:39] And Rajaratnam is still in prison?

[00:18:42] Right.

[00:18:42] He was sentenced to nine years?

[00:18:44] No, 11. He should be eligible for some kind of release in 2021.

[00:18:51] If you could put this insider trading case in the context of cases that came before and after, how does it differ? Is it a landmark case in some way?

[00:19:02] I think it's a landmark case in the sense that it was a coast-to-coast network of informants. It also ensnared informants from the corporate world. The last insider trading case — the notable one —

was, of course, the ones that were brought by Rudy Giuliani in the late '80s. This one, I think, encompassed more of corporate America. You had Rajat Gupta, but you also have Robert Moffat, an IBM executive, and it was also the first insider trading case where the government showed that it was prepared to use wiretaps to crack down on the crime. I think that sent quite a chilling message to everyone on Wall Street.

[00:19:44] Do you think the timing was especially relevant to the sentencing? A lot of this misconduct was 2008 — the middle of the financial meltdown, a lot of frustration with the environment on Wall Street.

[00:19:56] I don't think the timing was relevant to the sentencing, but I think the timing was relevant to the crimes. I suspect the wiretaps caught a lot of crime in 2008 because people — hedge fund managers who were just struggling to make money — you were going to try and get any edge that you could. Perhaps if these wiretaps had been in place in 2005, they may not have picked up as much as they did in 2008.

[00:20:26] Those wiretaps were played almost on a loop at the trial so that people were hearing things like, "Goldman Sachs is in trouble, and it's possible that this influx of cash will make a difference." It seems from the latter part of your book that there were just constant reminders at the trial of the precarious state of the financial markets.

[00:20:49] Absolutely. The great thing about the wiretaps is that they gave you this real-time window into how traders were feeling back in 2008. Remember, a lot of these cases were prosecuted, went to trial in 2011 and 2012 when the economy was recovering. But you were sitting there and having a ringside seat into the pressures that hedge fund managers were facing as Lehman was collapsing, as Washington Mutual was in trouble. It was riveting.

[00:21:20] As we wrap up then, has this had an impact on cleaning up Wall Street?

[00:21:25] Insider trading prosecutions probably have an afterlife of about two or three years, and then the rampant illegal practice of trading on inside information begins again. In the late '80s, we saw Rudy Giuliani conduct a number of high-profile arrests, including leading out a Goldman Sachs executive in handcuffs. For a while it seemed, Wall Street was cleaned up, but by the mid-'90s, when Raj was rising through the ranks of Needham, insider trading was starting to come back again. There were two studies out recently by some academics who said that insider trading is a very real part of the financial markets. They looked back at some of the trading that was done during the financial crisis, and they noticed that people who were politically connected to government traded much better in the nine months after TARP than they did in the two years before. I think insider trading comes and goes, and there was obviously a chill after the prosecution in 2011 and 2012, but it's probably alive and well again today.

[00:22:39] The temptation must be so great, because you imagine you're having this private conversation, and if you just show the least restraint in the amount of shares that you trade, it seems that it would be awfully tempting to imagine you could stay under the radar.

[00:22:54] As you know, Alexandra, I think memories are short. We saw e-mails being a big part of the financial crisis, the Enron era. Then people went back to using e-mails to say incriminating things, so I suspect insider trading is very much part of it.

[00:23:09] I think you're right. We're also hearing from people that there are all these new apps that immediately destroy communications, and that's got to be, on the one hand, making it harder for law enforcement, but on the other hand, giving people what's probably a false sense that things they want to keep private will stay private. A final link to current events: I mentioned at the outset that Raj was prosecuted by Preet Bharara — who's the former U.S. attorney for the Southern District of New York who was ultimately fired by Trump — but Raj was defended by John Dowd, who is now Trump's personal lawyer. This links forward into 2018 as well as back to previous insider trading scandals.

[00:23:50] It's quite a merry-go-round.

[00:23:52] Merry-go-round, there you are. Circular rather than linear. Thank you so much for your time, Anita. I really recommend the book. It's a great read with a lot of really interesting cultural overtones, as you say. This crime, like every crime, is not peculiar to any one community, but in this case it's woven neatly through the Indian American community, which makes for an interesting read. Thank you.

[00:24:14] Thank you so much, Alexandra.