



What Specific Steps Should a Hedge Fund Manager Take When the FBI Comes Knocking?

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The backdrop of the Galleon Group criminal trial, which began this week with jury selection, has brought renewed focus on hedge funds for insider trading and other investment frauds. Coupled with a series of high profile hedge fund investigations and prosecutions in the last few years, the trial of Galleon founder Raj Rajaratnam in federal court, in lower Manhattan, demonstrates the resolve and commitment of federal prosecutors and law enforcement to take aggressive actions within the financial district to detect, investigate, prosecute and deter such criminal activity.

Most hedge funds are reputable and their managers honest. However, select high profile criminal investigations against hedge funds such as Galleon, and its founder Rajaratnam, has left a public perception that the industry is tainted. The ongoing and spreading investigations have taken prosecutors, law enforcement and the Securities and Exchange Commission (SEC) deep into the hedge fund industry. With the aura of expanding investigations around them, many hedge fund managers, whether innocent or culpable, are concerned about being contacted and worried about the appropriate response if contacted.

What specific steps a hedge fund manager should take when the Federal Bureau of Investigation (FBI) comes knocking is an intriguing question. The simple answer is to consult with a lawyer. However, the question and the potential consequences are anything but simple. The reality is that there is no set answer to the question. Although many scenarios may be similar, every situation should be considered unique and handled on a case by case basis based on the distinctive events pertaining to that situation.

The question of what steps to take is influenced, and often, complicated by one's individual perspective. Experience shapes perspective. Based on our backgrounds, we possess varying perspectives. An FBI agent's perspective will be much different than that of a defense attorney. Although on the same team, an FBI agent and prosecutor will have similar yet differing perspectives. A hedge fund manager's perspective will be different than that of their attorney, as well as that of an FBI agent. Likewise, the general public will have a different perspective. Differing perspectives do not equate to right or wrong. They simply demonstrate that, based on our experience we view things differently and often act accordingly.

When FBI agents knock, they would prefer that a hedge fund manager cooperate and not involve a defense attorney at that point. In contrast, in almost all instances, a hedge fund manager's lawyer will recommend that the hedge fund manager not talk unless counsel is present. From an FBI agent's

perspective, it is not in their best investigative interest for the hedge fund manager to request a lawyer at the onset of a contact. However, an FBI agent will respect a hedge fund manager's request to speak to an attorney should one be requested. Regardless of whether a hedge fund manager decides to seek legal counsel or not, there are a series of specific steps that should be taken.

The first step is to understand the circumstances that led the FBI to come calling. Invariably, the FBI visit will be for informational or adversarial purposes. These two situations are extremely different and should be discernable from the outset. The key to understanding is listening. The hedge fund manager should be courteous, professional and listen carefully to the FBI agents. In most instances, the FBI agents will explain precisely why they are there. The hedge fund manager should listen intently, comprehend the situation, and consider the potential consequences at hand. The hedge fund manager should also consider that the FBI agents possess a different perspective. Part of the understanding process should be to try to comprehend the perspective of the other individuals involved in the encounter.

In an informational setting, the FBI is likely looking at the hedge fund manager as a witness or a victim. In either case, they are most likely looking for cooperation in obtaining information to assist in an ongoing criminal investigation. In almost every such case, at the point of the FBI's contact, the hedge fund manager has no criminal culpability. Therefore, providing truthful information should have no criminal consequence. However, the hedge fund manager should consider whether contact with the FBI would have an adverse impact on their business or reputation. Credibility and reputational risk are extremely important. In the event that a hedge fund manager chooses not to cooperate, they should consider whether an informational setting could turn into an adversarial situation.

In most informational settings, the scenario should be straight forward and the hedge fund manager should be as cooperative as possible.

Adversarial situations are much more complicated. In these scenarios, the hedge fund manager will more than likely be a criminal target of the investigation. In this situation, it is critically important to listen to what the FBI agents have to say. The FBI agents will likely attempt to solicit cooperation. In so doing, they will lay out fragments of evidence they have obtained, to include possible sound bites of court ordered or consensually recorded conversations. In this situation, the hedge fund manager should pay close attention to all of the information disclosed by the FBI agents.

In most situations like this, especially where conversations have been recorded, the government is highly successful in prosecuting these cases. Under such circumstances, it is often in the best interest of the target to cooperate with the FBI. Cooperation could range from admitting guilt and pleading guilty to agreeing to work with FBI agents to obtain evidence against other subjects of the investigation. Deciding to cooperate is an extremely difficult decision to make. At some point in the process, either right up front or as the situation unfolds, the subject will require legal representation. The subject should seek a written cooperation agreement with the appropriate prosecutors' office.



In either an informational or adversarial situation, the hedge fund manager should consider whether speaking to the FBI poses potential regulatory enforcement issues with the SEC. If so, and they plan to cooperate, they should seek a written cooperation agreement with the SEC.

There are some steps a hedge fund manager should take long before being confronted with the prospect of a visit from the FBI. Those steps start with establishing and maintaining an effective compliance program. One of the critical elements of such a program is the “tone at the top”. The hedge fund manager must set the example of demonstrating a strong commitment to compliance. Important components of a compliance program that should keep a hedge fund out of trouble include well defined policies and procedures, especially regarding insider trading, and adequate due diligence practices pertaining to clients, employees and investment or business partners.

The prospect of having FBI agents standing at your door can be, at a minimum, stressful and unsettling. However, it does not have to be devastating. Understanding the situation by carefully listening to what the FBI agents have to say, comprehending perspective, and assessing the potential consequences, should set the stage for the appropriate response and mitigation of potential adverse outcomes.

