

IS STEVEN COHEN THE FEDS' MOBY DICK?

A U.S. investigation into insider trading by hedge funds may scar but probably won't mortally wound Steven Cohen and his SAC Capital Advisors fund



Former SAC Capital Advisors employee Donald Longueuil covers his face as he is led by his lawyer from the Manhattan Federal Courthouse in New York February 8, 2011. REUTERS/BRENDAN MCDERMID

BY MATTHEW GOLDSTEIN AND
SVEA HERBST-BAYLISS
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SOON AFTER U.S. PROSECUTORS charged two of his former employees with trafficking in confidential corporate information earlier this month, Steven A. Cohen kicked his hedge fund's damage control operation into high gear.

In the morning, top managers at SAC

Capital Advisors, LP's headquarters in Stamford, Conn., calmly fanned out to allay any concerns the 250 analysts and traders at the \$13 billion fund firm might have about the insider trading charges against the two former employees, Donald Longueuil and Noah Freeman. A separate outreach program went on with SAC Capital's wealthy investors, some of whom had anxiously called up within minutes of the news hitting the wires.

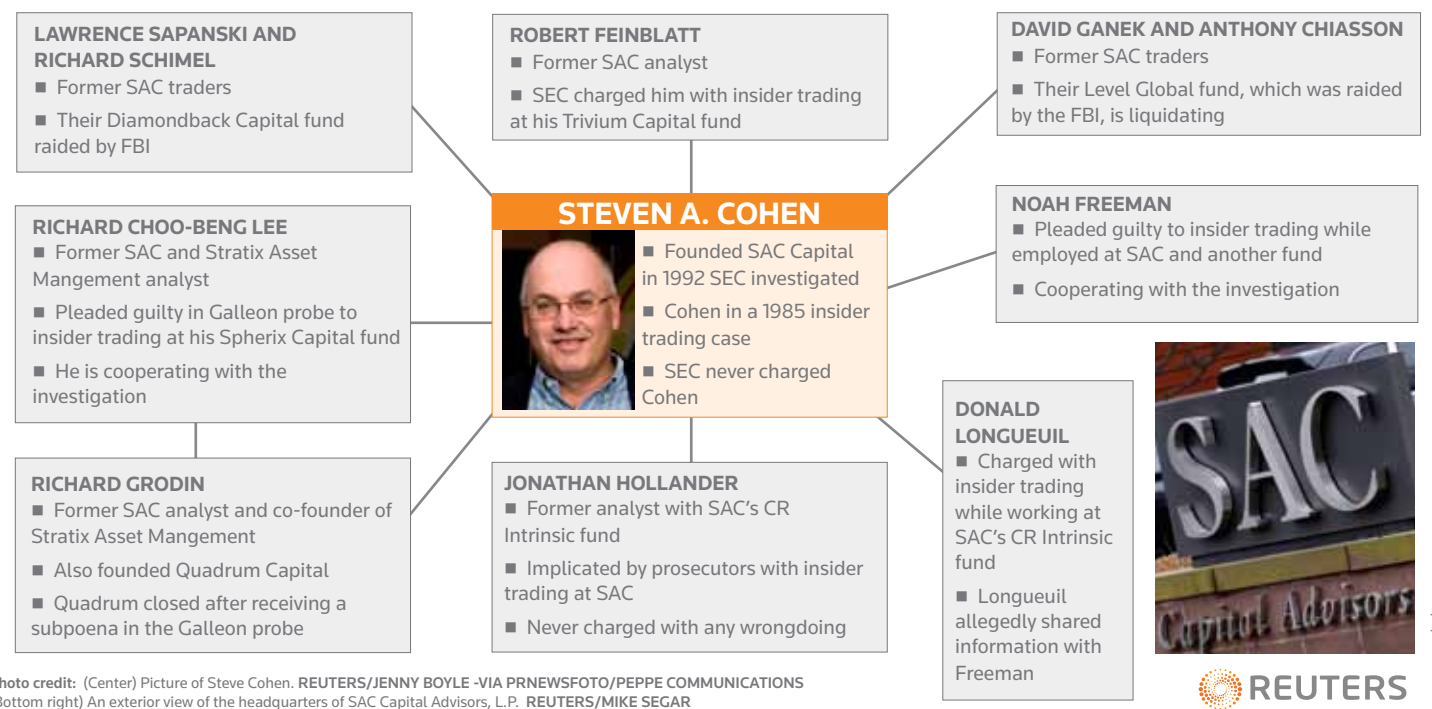
By lunchtime, a spokesman for SAC Capital issued a statement calling Longueuil's and Freeman's actions "outrageous." It also said both men obviously circumvented SAC Capital's considerable compliance, deftly concealing their activities.

Three weeks later, Cohen's crisis management strategy appears to be paying off.

Judging by their words and wallets, SAC Capital's clients, including a large

SAC of trouble

Former SAC employees touched by insider trading probes



Reuters graphic/Alison Victor

Blackstone Group investment fund, are giving the legendary 54-year-old trader the benefit of the doubt. Officials with several investment funds said that while the insider trading charges are unnerving, it's not enough to prompt them to pull money from the 19-year-old fund with a record of generating high double-digit returns.

Indeed, even in the wake of the Feb. 8 charges, some people inside and outside the \$1.9 trillion hedge fund industry are whispering that U.S. authorities, who have spent at least four years looking for evidence of wrongful trading at SAC Capital, may come up as empty-handed as Captain Ahab did in his hunt for the great white whale Moby Dick.

In talking with nearly two-dozen former SAC Capital employees, investors, money-managers, defense lawyers and former prosecutors, there is a sense that federal authorities are fighting last year's battle in focusing so much energy and resources on Cohen and his associates.

What has complicated the matter, these people say, is the fact that the SAC Capital of today is very different from the high-flying fund of 10 years ago. Back then, it was renowned for an anything-goes trading culture that routinely produced spectacular

annual returns of 50 percent or greater. Nowadays, Cohen's shop still outperforms most hedge funds, but it no longer ranks at the top of the pack in terms of performance.

"Stevie has been investigated for so long and he is not trading the way he has in the past," said one former prosecutor now in private practice. "I would be shocked if they are able to get anything on him."

KANG AGAIN

IT'S NO SECRET PROSECUTORS and agents with the Federal Bureau of Investigation have been strenuously trying to make an insider trading case against either people who work for Cohen or who left SAC Capital to establish their own firms.

Two months after prosecutors charged billionaire trader Raj Rajaratnam in one of the biggest insider trading cases ever, Reuters reported in December 2009 that B.J. Kang, one of the FBI agents who arrested the Galleon Group co-founder, also had been investigating Cohen and his fund on-and-off since at least 2007, along with FBI agent David Makol.

Not surprisingly, Kang was the FBI agent who oversaw Longueuil's early morning arrest on Feb. 8 at his Manhattan apartment.

Kang also had a hand in the plea negotiations with Freeman, who has agreed to cooperate with authorities.

Still, the charges against the two men, both of whom had relatively brief stints at SAC Capital, are a far cry from implicating Cohen in anything improper. As one money manager who knows Cohen observed, SAC Capital's mostly wealthy individual investors appear to have a high tolerance for negative headlines, as long as the fund keeps generating better than average returns and Cohen himself isn't charged.

Another money manager, Jeffrey Vale, whose Infinity Capital Partners has money with Cohen, seemed unfazed by the insider trading charges. "This is something we will watch going forward," said Infinity Capital's chief investment officer.

In fact, over the past two years, the hedge fund has attracted some \$2 billion in new money from investors, said a person familiar with SAC Capital -- despite countless news stories about the investigation. The money has kept pouring in even after a lawsuit filed by Cohen's ex-wife revealed that securities regulators questioned him in an insider trading investigation some 25 years ago.

By contrast, some of Cohen's former

associates haven't fared so well. SAC Capital alums David Ganek and Anthony Chiasson are throwing in the towel and closing their one-time \$3 billion Level Global Investors fund, after investors ran for the exits following an FBI raid last November. The two were swamped with redemption requests even though no one at the fund has been charged with wrongdoing.

Diamondback Capital Management, another fund founded by former SAC Capital traders that was raided by the FBI in November, has also had a hard time calming investor angst over the investigation. To date, investors have asked to redeem \$1.3 billion from the \$5 billion fund. But unlike their former colleagues at Level Global, SAC alums Lawrence Sapanski and Richard Schimel are vowing to keep Diamondback in business and some prominent pension funds like the state of New Mexico are sticking with them.

None of this is to say federal authorities are wasting their time in looking at Cohen and his former associates. The charges against Longueuil and Freeman certainly suggest that some at SAC Capital may have traded on improper inside information. But the question is whether their alleged activities were simply a couple of employees going rogue, or a sign of something more seriously wrong with the firm's DNA?

COHEN'S LAMENT

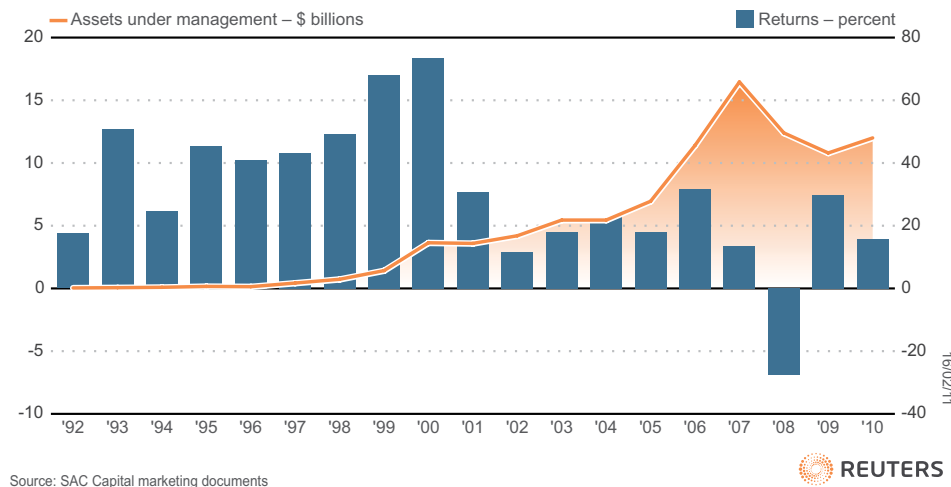
PEOPLE FAMILIAR WITH COHEN, who through his longtime spokesman Jonathan Gasthalter declined to comment for this story, describe him as personally irritated by the government's focus on him and his fund. In meetings with prospective investors, Cohen is likely to point out correctly that SAC Capital has built one of the largest compliance teams in the hedge fund industry. In his mind, these sources say, he's being demonized largely because of his success.

On paper, SAC Capital compliance is indeed second to none in the hedge fund industry, with about 30 people working on compliance and due diligence issues at the firm -- many of them lawyers.

As a regular part of its compliance sweep, SAC Capital reviews personal trades made by its employees, prohibits them from buying shares in initial public offerings and limits their ability to trade certain stocks the fund is trading, according to an SAC Capital due diligence questionnaire given to prospective investors and obtained by Reuters. From time-to-time, the hedge fund also puts stocks on a do-not-trade list, especially if the

SAC Capital by the numbers

Size isn't everything when it comes to hedge funds. Shown below, as assets under management have grown at Steven Cohen's SAC Capital, the fund's outsized performance has waned in recent years.



BLOG

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<http://link.reuters.com/heq72q>

compliance teams believes a manager may have come into possession of non-public information.

But many of SAC Capital's stiff compliance rules only occurred within the past decade with Cohen's hiring of Peter Nussbaum, a former Schulte Roth & Zabel hedge fund lawyer, as general counsel. And skeptics question whether the fund's stepped-up compliance actually deters bad behavior or simply drives it underground.

People familiar with the firm say SAC Capital's legal team actively discourages traders and analysts from using email, instant messages and other forms of communication that can leave a paper trail. The lack of email documentation at SAC Capital is something that has frustrated litigants over the years, according to people who have been involved in lawsuits and arbitrations with the fund.

In the criminal complaint charging Longueuil with insider trading, federal authorities said he and Freeman and two other people who didn't work at SAC Capital "undertook efforts to conceal the scheme from regulatory and law enforcement agencies" by not using their office email accounts or computers to "communicate about inside information." Rather, prosecutors say the

men relied on personal email accounts and personal computers to save "any electronic records evidencing their communications with company insiders."

Defense lawyers say one reason prosecutors took the unusual step of seeking court permission to secretly wiretap phone calls made by Rajaratnam and other hedge fund traders during the Galleon probe was because many in the industry had wised up some time ago to the potential dangers of email. These same lawyers noted that in the wake of Rajaratnam's arrest, in October 2009, many in the hedge fund world are careful about what they say on the phone as well.

To some degree, Cohen may be right in maintaining that he's being scrutinized because of his success. Former prosecutors said it's not uncommon for Wall Street financiers who achieve a high level of early success to draw interest, especially if they exist in a largely unregulated industry like hedge funds and become extremely rich very, very quickly.

Cohen, who launched SAC Capital in 1992 with \$25 million, is worth \$6.6 billion, according to Forbes. Today, much of his net assets remains tied-up in SAC Capital, which continues to charge outside investors some of the highest fees in the hedge fund industry.

SAC Capital's very structure, in which Cohen sits at the top of the food chain and requires all his traders to regularly share with him what the firm's marketing material calls their "high conviction ideas," has also raised

eyebrows. Critics say it's hard for Cohen to argue he doesn't know what is going on with his traders and analysts when his own guidelines place him at the center of all trading.

Indeed, the fund's 2009 due diligence questionnaire describes SAC Capital as operating in a "hub and spoke trading structure where Steven A. Cohen and his team are the hub of receiving information from the various spokes of portfolios managers." Cohen and his team then decide which of those "high conviction ideas" to use for making trades in the investment portfolio that he directly oversees.

This so-called Cohen account, with about \$4 billion in capital, is the single-largest trading account at SAC Capital. All other teams of traders at SAC Capital typically control accounts with between \$300 million and \$500 million. For instance, Longueuil, when he was at SAC Capital, managed one of these smaller accounts, according to prosecutors.

SAC'S EDGE

IT'S NOT JUST COHEN'S personal wealth, which includes a 36,000 square-foot mansion in Greenwich, Connecticut, or SAC Capital's early eye-popping returns, that have brought the star trader to investigators' attention. The fund's famously ravenous appetite for information on publicly traded companies is also a classic red flag for securities cops.

In fact, SAC Capital began employing the so-called mosaic theory of stock investing, which relies on analysts to get information about a company from many disparate sources, long before that phrase became fashionable on Wall Street.

Experts say federal authorities appear to believe that big stock-trading hedge funds like SAC Capital, in putting together their

investment mosaics on stocks, are potentially pushing the envelope by seeking out non-public information on sales, new product lines, earnings and acquisitions.

"There is a certain frustration that the general public and the government have with successful hedge funds and the government wants to make sure the playing field is level," said John Longo, a professor of finance at Rutgers University and a senior vice president with MDE Group, an investment firm that invests with hedge funds.

Longo said some might see the government focus on SAC Capital or funds founded by former SAC Capital people as "being overzealous." But Longo said he has no problem with the government's apparent focus on SAC Capital as long as prosecutors have "very strong evidence" to justify the scrutiny.

For his part, Cohen makes no apologies for what his fund's marketing literature proudly describe as "SAC's Edge" when it comes to employing traders and analysts who "have extensive contact with corporate management, vendors, customers, consultants and other industry participants."

Another SAC Capital "edge" comes from the huge trading commissions the

fund regularly funnels to financial firms. Historically, all those dollars showered on Wall Street have given SAC Capital traders and analysts unparalleled access to stock research and meetings with corporate executives.

One way SAC Capital has maintained that information dominance is by employing five prime brokers, including Goldman Sachs Group, Morgan Stanley and JPMorgan Chase to loan it money and execute trades. The hedge fund also has banking relationships with Bank of New York Mellon, Citigroup and HSBC.

SAC Capital also has been one of the big spenders on expert network firms -- the matchmaking shops that pair hedge funds with corporate managers, physicians, or engineers moonlighting as industry consultants. One thing federal investigators are examining is whether some consultants working for expert network firms are being paid to share corporate secrets.

In August 2009, Cohen sought to get even more insight into publicly-traded companies by hiring long-time Deutsche Bank broker Sam Evans, who is also a top amateur golfer, to arrange golf outings for corporate executives on some of the nation's

SAC INVESTMENT RESEARCH	
Use of Outside Sources	SAC has over 130 research analysts. These analysts use information from a variety of sources in forming their investment views, including research boutiques, sell side firms, and proprietary company specific analysis.
Research Process	Research is a bottom-up process driven by primary and secondary fundamental research. SAC's analysts usually focus on particular industry verticals and assess the fundamental outlook for their industries and individual companies. They meet with companies, suppliers, vendors, and other market participants, build company and industry models, and make long and short investment recommendations as a result of their work. While SAC's portfolio teams do look at comparable financial ratio comparisons and time series for the companies they monitor, the process is fundamentally rather than quantitatively driven. Each position is driven by an investment thesis, a time frame, and an assessment of risk/reward.
Typical Flow of an Investment Idea from Inception to a Trading Position	In the equity long/short space, a typical portfolio manager and his team will research ideas in companies, catalysts, upside/downside, and potential paths a specific stock price might take. After arriving at a conviction level for an idea, the portfolio manager will decide on price levels and targets at which he will enter into the position as well as the ultimate size of the position. The average portfolio manager will construct a portfolio consisting of 20-40 names and will make subsequent refinements to the portfolio to ensure that top down portfolio construction constraints (such as net market value exposure, liquidity, etc.) are met. Each portfolio manager is further responsible for sharing high conviction ideas with Steven A. Cohen and his portfolio team in a "hub and spoke" trading structure where Steven A. Cohen and his team are the hub of receiving information from the various spokes of portfolio managers. Steven A. Cohen and his team will then decide whether to include the idea in his portfolio as well.
Position Sizing	Equity long/short portfolio managers develop conviction in specific stock ideas. The conviction level is the size of a position the portfolio manager is willing to take. The conviction level is an

SAC FACTS: An excerpt from a 2009 due diligence questionnaire prepared by SAC Capital for prospective investors.

top courses. The small and intimate rounds often would be attended by a select group of SAC Capital traders and analysts. Cohen recently put a halt on the golf excursions after Reuters reported on them in November. Evans, meanwhile, remains part of SAC Capital's 25-person marketing and business development team.

Cohen's supporters say that the private golf outings, just like the information advantage SAC Capital gets from paying out millions of dollars a year in trading commissions, is all part of what a savvy trader and money-manager is supposed to do. It's the kind of research and information gathering that separates star traders from the mere mortals who buy and sell stocks online with an E*Trade or Ameritrade account.

But skeptics say the pressure Cohen's fund puts on analysts and traders to get an "edge" can create a culture where crossing the line, if not officially countenanced, can occur and even flourish.

WINING AND DINING

JONATHAN HOLLANDER, a former SAC Capital analyst, who prosecutors have said in court papers received inside information while working for Cohen's fund, is an illustration of the lengths some of Cohen's employees will go to get an "edge." Prosecutors, in a December 1, 2010 court filing, describe a January 2006 dinner meeting between Hollander, former UBS investment banker Nicos Stephanou and Blackstone investment banker Ramesh Chakrapani, during which the three one-time friends discussed the status of then on-and-off buyout talks involving the Albertson's supermarket chain. During the dinner, Hollander allegedly talked about "material nonpublic information" about the deal that prosecutors say he got from Chakrapani.

Later in the evening, when Hollander wasn't around, prosecutors say Stephanou asked Chakrapani why he talked to Hollander about the deal for the supermarket chain. Prosecutors allege the former Blackstone banker did so because "Hollander was constantly asking Chakrapani for information regarding the transaction."

Stephanou told prosecutors about the dinner as part of his plea negotiations, which led to him becoming a key cooperating witness against a number of people he provided inside information to over the years. Prosecutors disclosed the dinner in a December court filing outlining the extent of Stephanou's cooperation.



COHEN'S THRONE: An exterior view of the headquarters of SAC Capital Advisors, L.P. in Stamford, Connecticut, in this picture taken December 13, 2010. **REUTERS/MIKE SEGAR**

So far, Hollander, whose lawyer declined to comment, has not been charged with insider trading. In spring 2009, prosecutors voluntarily dismissed a related criminal case they filed against Chakrapani. His lawyer said "prosecutors jumped the gun in concluding that Mr. Chakrapani had engaged in any wrongdoing."

Still, the January 2006 dinner, if it occurred as Stephanou said, is illustrative of the kind of jockeying and sharing of information that prosecutors and securities regulators seem to believe is common in some quarters of the hedge fund industry. Then again, Cohen supporters point out that the dinner occurred some five years ago, back when Wall Street was still in a buyout frenzy and collateralized debt obligations hadn't yet become a four-letter word.

SOFT AS FLEECE

INDEED MANY NOTE THAT in the wake of the financial crisis, Cohen is doing everything he can to present himself in a different light. Whether it's because of his chronic bad back, the awful beating his fund took in 2008 or the government investigation, the once publicity-shy manager is stepping out a bit into the limelight.

Last year he allowed himself and his

wife to be profiled in an article in Vanity Fair that featured a photo shoot by famed photographer Annie Leibovitz. Lately he's been inviting reporters and columnists for off-the-record chats to his office or palatial Greenwich, Connecticut estate.

An avid art collector who has regularly given millions of dollars each year to charity, Cohen is now focused on legacy building. Last April, North Shore-Long Island Jewish Health System renamed its pediatric center the Steven and Alexandra Cohen Children's Medical Center of New York, after the charitable foundation set up by Cohen and his wife pledged a \$50 million donation.

This softer image Cohen is trying to strike may not be as warm and fuzzy as the official SAC Capital fleece jacket that blogger Bess Levin has made into an iconic symbol on Dealbreaker.com. But it is quite a change for a manager with a long history of yelling at traders for failing to make him money on a trade.

And that's not the only telling change at SAC Capital. The fund, which took outsized risks on stocks in its early days, is now taking a more restrained approach. In the wake of 2008, when one of SAC Capital's funds lost 27 percent of its value and Cohen fired dozens of traders, managers are now more restricted

as to the amount of risk they can take on.

The hedge fund's marketing literature said traders are taking less risk by design to reduce volatility in the wake of the financial crisis. But less risk, also means less reward and less than outsized performance.

Some see signs that SAC Capital is becoming a maturing fund that will no longer be making a killing the way it did when Cohen was starting out. In 2010, SAC Capital returned 16 percent, after fees. That is better than the industry average of 10 percent, but a

far cry from the blow-out numbers posted by other famous managers like William Ackman, Dan Loeb, John Paulson or Ray Dalio.

The legendary trader no longer sits atop the hedge fund world when it comes to outsized performance. In some ways, Cohen is just becoming another well-paid manager posting good but not eye-jarring numbers.

"In the hedge fund business there are always some superstars, like John Paulson, who can maintain the same standard of outperformance, but based on these recent

numbers it does not look like Steve Cohen is that anymore," said Nicolas Bollen, a professor of finance who studies hedge funds at Vanderbilt University's Owen School of Management.

For Cohen, the thought of no longer being seen as a hedge fund superstar may hurt more than anything prosecutors or regulators can say about him.

(Editing by Jim Impoco and
Claudia Parsons)

FUN FACTS ABOUT STEVEN COHEN'S SAC CAPITAL

BY SVEA HERBST-BAYLISS
AND MATTHEW GOLDSTEIN

IN THE 19 YEARS SINCE Steven A. Cohen used about \$25 million to start his own hedge fund, SAC Capital Advisors has grown into a \$13 billion behemoth, one of the industry's biggest and most powerful. Cohen, known for pushing his staff hard, is equally tough on himself. He puts in long hours on his 20,000-square-foot trading floor, which is cooled to around 69 degrees to keep employees wide awake, wooing potential investors over a round of golf or intimate dinners, and reviewing many job applications personally.

Here is a list of little-known facts about Cohen's 800-employee business.

- Cohen located his Disaster Recovery data center in the village of Wappinger Falls, population 5,000, roughly 65 miles (105 km) northwest of the firm's Stamford, Connecticut headquarters. To make sure no data, including email, is ever lost, the site is on a different power grid from the Stamford and New York sites and has an uninterrupted power supply with an emergency generator.

- Sticking with the idea of not having all his eggs in one basket, Cohen uses five prime brokers -- Goldman Sachs, Morgan Stanley, Credit Suisse, JPMorgan and

Barclay's Bank -- more than the two or three prime brokers most other fund firms use.

- PricewaterhouseCoopers LLP has combed through the books of SAC funds since 1994 as the firm's official auditor.

- SAC manages over seven dozen portfolios with SAC Capital Associates being both the oldest continuously active portfolio and its largest current portfolio, the firm said in 2009.

- While SAC stands for its founders initials, the man doesn't work alone. In his seven offices around the world, he employs over 90 portfolio managers, 130 research analysts, more than 30 trading execution specialists and more than 30 people in compliance and due diligence.

- Like other hedge fund firms, SAC incorporates its offshore funds on tropical islands with five organized in the Cayman Islands, where the bulk of the world's hedge funds are located. But SAC also located eight portfolios in Anguilla, where fees are generally lower.

- While Cohen himself may be eager to save where he can, he's not bashful about making his clients pay some of the highest fees in the hedge fund industry that investors say amount to a roughly 3 percent management fee and a roughly 50 percent performance fee. Several investors said

they "hate" the high fees but are sticking with him for now.

- Just in case something should go wrong, SAC says it has investment advisor/investment fund management and professional liability insurance with coverage of about \$30 million.

- The firm says that its funds employ "significant leverage" which allows them to magnify their exposure and lists a ratio of 3-4 to 1 for funds pursuing long/short equities strategies. The S.A.C. Select Fund, LLC (long/short equities with lower net exposure) employs leverage of 5 to 1 and quantitative equities use leverage of 8 to 1.

- Over the years, Cohen has attracted hundreds of wealthy clients as well as powerful institutional investors such as the Blackstone Group's fund of funds unit, whose investments can often bestow a sort of seal of good housekeeping on a firm. Others investors include Hatteras Funds, and Infinity Capital Partners.

- When he's not working, Cohen can relax at his 36,000-square-foot home, shooting hoops on his basketball court, swimming in an indoor pool, or turning figure eights on an ice skating rink.

(Editing by Claudia Parsons
and Jim Impoco)

Sources: SAC marketing information and
due diligence questionnaire

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