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SEC Charges 2 Ex - State Street Workers Over Subprime

By REUTERS

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BOSTON/NEW YORK (Reuters) - Two former top State Street Corp. executives were hit with securities fraud charges on Thursday for misleading investors about a risky subprime mortgage-laden fund and tipping off favored clients.

The U.S. Securities and Exchange Commission said it charged John Flannery, a former member of State Street's executive management group, and James Hopkins, the former head of product engineering for North America.

The civil charges come nearly eight months after State Street, one of the world's biggest institutional investors with $1.9 trillion under management, agreed to pay more than $300 million to settle related charges by state and federal regulators.

According to the SEC's complaint the pair marketed State Street's Limited Duration fund, which once had $1.4 billion of assets, as a portfolio for investors who wanted better returns than in money funds but with little risk to principal.

But by 2007, the fund was almost entirely invested in subprime mortgage-backed securities and derivatives, the SEC said. In the first three weeks of August 2007, the fund lost 37 percent of its value soon after credit conditions generally began to tighten.

"Hopkins and Flannery played an instrumental role in drafting the misrepresentations in these investors communications." the SEC said in its complaint.

"At the same time, State Street provided certain investors with accurate and more complete information about the Fund's subprime concentration," the SEC added.

Later Flannery and the company's Investment Committee directed State Street to sell the fund's most liquid holdings to help the better informed investors, including the company's pension fund, get out, the SEC said. That left the fund with largely illiquid holdings, the SEC said.

Lawyers for both men said they were disappointed the SEC filed the civil administrative proceedings.

State Street's "experienced lawyers reviewed the content, provided edits and approved the final versions. It is unfair and unjust that the SEC has chosen to bring these civil charges when Mr. Flannery believed that the communications were accurate, and he followed the advise of SSGA's lawyers at all times," Flannery's lawyer Mark Pearlstein said.

For State Street, the matter hurt investor confidence, several analysts said, after the CEO addressed the losses only briefly on an earnings call two months later.

Since then a number of top executives, including Flannery and William Hunt, the former head of the company's State Street Global Advisors asset management unit, left the company.

Ronald Logue, State Street's longtime chief executive, retired on March 1 this year.

Hopkins had been promoted to head of product engineering for North America in 2008, but no longer works at the company, a State Street spokeswoman said on Thursday.

"State Street has resolved this matter both in terms of addressing client concerns as well as settling with the SEC and will not comment on the SEC's separate investigations into individuals who are no longer with the firm," the spokeswoman, Carolyn Cichon, said.

In addition to the $300 million, State Street agreed to pay roughly $350 million to settle private lawsuits over its investments.

Shares of State Street were up 1.6 percent at $37.95 in afternoon trading on the New York Stock Exchange.

(Reporting by Svea Herbst-Bayliss in Boston and Jonathan Stempel in New York. Editing by Lisa Von Ahn and Robert MacMillan)