

COMMONWEALTH OF MASSACHUSETTS

SUFFOLK, SS:

SUPERIOR COURT
DEPARTMENT OF THE TRIAL COURT

_____)
COMMONWEALTH OF MASSACHUSETTS,)
)
	Plaintiff,)
)
v.)
)
STATE STREET BANK AND TRUST CO.,)
)
	Defendant.)
_____)

COMPLAINT

Civil Action
No. **10-0446**

MICHAEL JOSEPH O'NEAL
 CLERK/MAGISTRATE
 2010 FEB -4 AM 11:48

PRELIMINARY STATEMENT

1. The Commonwealth of Massachusetts, by and through its Attorney General Martha Coakley, brings this enforcement action in the public interest pursuant to the Massachusetts Consumer Protection Act, G.L. c. 93A and the Massachusetts False Claims Act, G.L. c. 12 § 5C. The complaint seeks civil penalties, restitution, and other damages arising from the unfair and deceptive acts or practices of Defendant State Street Bank and Trust Company ("State Street") in and/or causing harm in Massachusetts. The Commonwealth also seeks such equitable relief as may be determined to be appropriate to remedy, address, and prevent additional harm arising from State Street's unlawful conduct, the costs of investigating and prosecuting this action, including reasonable attorneys' fees, and civil penalties.

PARTIES

2. Plaintiff is the Commonwealth of Massachusetts, represented by the Attorney General, who brings this action in the public interest.

3. Defendant State Street is a wholly owned subsidiary of State Street Corporation, which is a publicly registered financial holding company. State Street is a bank organized under the laws of the Commonwealth of Massachusetts with its principal place of business in Boston, Massachusetts. State Street Global Advisors ("SSgA") is a division of State Street and is publicly described as its "investment management arm."

JURISDICTION AND VENUE

4. The Attorney General is authorized to bring this action pursuant to G.L. c. 93A, § 4, G.L. c. 12, § 10, and G.L. c. 12, § 5C.

5. This Court has jurisdiction over the subject matter of this action pursuant to G.L. c. 93A, § 4, G.L. c. 12, § 5C, G.L. c. 12, § 10, and G.L. c. 214, § 1.

6. This Court has jurisdiction over Defendants pursuant to G.L. c. 223A, §§ 3(a)-(d).

7. Venue is proper in this Court pursuant to G.L. c. 93A, § 4 and G.L. c. 223, § 5.

FACTUAL ALLEGATIONS

A. Background

8. State Street, through its subdivision and investment management arm, SSgA, offers a broad range of investment management products and services within Massachusetts and throughout the United States. In a 2008 Form 10-K filed by State Street's parent company with the U.S. Securities and Exchange Commission, SSgA is described as the "largest manager of

institutional assets worldwide” and the “largest manager of assets for tax-exempt organizations (primarily pension plans) in the United States.” SSgA’s total assets under management totaled \$1.44 trillion at year-end 2008, and \$1.98 trillion at year-end 2007.

9. Among the investment products offered by State Street are bond funds and a commodities futures index fund, which are unregistered collective trust funds actively managed by State Street’s fixed income portfolio management team. The approximately 40 funds at issue in this action (the “Fund(s)”) were organized as common trust funds or collective investment trusts, over which State Street acted as trustee and fiduciary at all relevant times. The Funds were established by State Street, acting as trustee and fiduciary, pursuant to, *inter alia*, the State Street Bank and Trust Company Global Managed Common Trust Funds Declaration of Trust dated August 12, 1997 (amended on February 1, 2004), and the State Street Bank and Trust Company Investment Funds for Tax Exempt Retirement Plans Declaration of Trust dated February 21, 1991 (amended on July 19, 1991; March 13, 1997; December 22, 2003; and October 1, 2005).

10. Under such declarations of trust, State Street assumed “exclusive management and control” of the Funds. State Street, through its subdivision SSgA, had discretion to invest the Funds in accordance with investor objectives, and owed fiduciary duties to the Funds’ investors, including the duty to disclose all material facts relevant to those investors’ investment decisions and the duty to treat similarly situated investors fairly and impartially. In 2007, the Funds accounted for approximately \$13 billion in State Street’s assets under management. These Funds included, *inter alia*, Limited Duration Bond Fund (“LDBF”), the Bond Market Common Trust Fund (“CTF”), Bond Market Non-Lending Fund, Intermediate Bond Common Trust Fund, Short Term Bond Common Trust Fund, Government Bond Common Trust Fund, Government

Credit Bond Non-Lending Fund, High Yield Bond Common Trust Fund, Enhanced Dow Jones
AIG Commodities Futures Common Trust Fund, Balanced Growth Active Securities Lending
Fund, Global Fixed Income Opportunities Securities Lending Fund, U.S. Dollar LIBOR Plus
Common Trust Fund, and Absolute Mortgage Return Fund.

11. State Street's publicly announced investment strategy for the Funds centered on seeking to match or exceed returns in a benchmark index determined for each Fund. These indices typically consisted of composite baskets of representative fixed income securities in certain sectors, and the Funds, in turn, were designed to track the index (or achieve "beta" returns), while attempting to achieve modest "alpha" returns above the benchmark. In achieving such "alpha" returns, the Funds in most cases were intended to take "moderate" active risk, or seek attractive returns while "controlling risk" or "preserving capital." These risk descriptions were material to investors, who relied on them in making their investment decisions.

12. A total of about 270 customers were invested in the Funds in 2007, including about 50 investors based in Massachusetts. The affected investors included charities, nonprofit organizations, universities, pension systems, and certain political subdivisions of the Commonwealth of Massachusetts. At all relevant times, State Street conceived of, approved, and carried out its actions as described herein in the Commonwealth of Massachusetts, making statements including misrepresentations and omissions and committing unfair and deceptive practices against customers located both in Massachusetts and throughout the United States.

B. State Street's Investments in the Subprime Market

13. Over time, the Funds encountered difficulties in meeting their benchmarks and retaining low volatility while also maintaining a diversified portfolio. In or about 2006, and

contrary to the basic objectives of the Funds, State Street embarked on a risky and aggressive strategy to seek “alpha” returns by investing heavily in securities backed by “subprime” home mortgage loans. State Street achieved this by concentrating nearly 100% of its principal active fixed income fund (“AFI”), the LDBF, in subprime-related investments. LDBF was leveraged by a factor of 3.34 by the end of July 2007 (meaning that the “notional value” of the fund exceeded actual, invested capital by over 300%). LDBF gained such leverage through the use of sophisticated derivatives and investment vehicles, such as credit default swaps, reverse repurchases, and total return swaps, all tied to the subprime market, thus concentrating and increasing the Fund’s exposure to the subprime marketplace. Other Funds, in turn, were invested either indirectly in LDBF (in a “fund of funds” structure), or directly in the underlying subprime securities. “Subprime” mortgages refer to residential home loans issued to credit-blemished borrowers with relatively low “FICO” scores (these scores are an attempt to measure credit-worthiness of borrowers; low scores are meant to represent a higher risk of a borrower defaulting on a debt). The high risk of default among such borrowers translates to risks for securities holders, whose income streams are tied to the borrowers’ continued mortgage payments. These risks were magnified beginning in late 2006, as declining house values began to eliminate refinancing options for borrowers.

C. Subprime Losses in 2007

14. Starting in early 2007, the subprime mortgage market suffered a downturn that led to dramatic losses in State Street’s subprime investments. For instance, in February 2007, several of the Funds underperformed their benchmarks by 51 to 380 basis points (“bps”)—one “basis point” refers to one-hundredth of a percent, meaning that the Funds performed 0.51 to 3.81 percent points worse than one-month returns in their corresponding benchmarks. Losses of

this magnitude were unprecedented, as most of the Funds had experienced steady growth for many years prior to 2007.

15. Internally, State Street quickly recognized the gravity of these losses. Beginning on or about February 28, 2007, State Street's "product engineers" ("PEs") began to circulate internally "Client at Risk" ("CAR") alerts to inform Relationship Managers of events in the subprime market. As indicated in State Street's policies and procedures, the term "Client At Risk" refers to the fact that a client's *business* may be at risk—including for reasons of portfolio losses; it is because of such losses in its Funds that State Street began to circulate CAR alerts in late February 2007. Significantly, State Street also engaged, for the first time in its history, the most stringent (called "hard stop") fixed income risk management procedures, consequently involving the highest level executives in making investment decisions regarding LDBF.

16. After February 2007, State Street continued to generate CAR alerts, including those on about March 30, April 16, and July 2, 2007. In addition, State Street made available to its Relationship Managers ("RMs"), via its intranet, regular market updates, including monthly commentaries and PE postings called the "buzz." And, State Street's fixed income team met regularly with RMs to discuss developments in the subprime market.

17. By the end of June 2007, underperformance in several Funds had increased to a magnitude of 63 to 432 bps based on yearly returns. Some of the Funds even exceeded their "maximum" annual tracking error (or deviation from the benchmark), which State Street had established as a guideline for portfolio managers.

D. State Street Issues Uniform Misleading Statements to Affected Investors

18. On about July 26, 2007, State Street for the first time sent a uniform communication regarding these issues to all affected investors in State Street's Funds. However, while discussing the subprime market generally, the July 26 letter failed to disclose material information necessary for investors to decide whether to remain invested in the Funds.

19. In particular, the letter did not disclose the full extent of the funds' subprime exposure and the fact that the funds' losses were almost exclusively attributable to such subprime holdings. The letter also did not disclose the extent to which sophisticated derivatives and other investment vehicles, such as collateralized debt obligations, total return swaps, and reverse repurchases, were included in the Funds. As trustee and fiduciary to the Funds, State Street owed a duty to disclose such material facts relevant to their customers' investment decisions.

20. Significantly, the July 26 letter further misled investors regarding another material fact: that certain advisory groups within State Street—Office of Fiduciary Advisors (“OFA”) and Global Asset Allocation (“GAA”)—had decided as of July 26 to recommend *full liquidation* from the Funds by their clients; these groups began to inform their clients of this decision on or about July 26 and 27, respectively. Notwithstanding such actions by its own advisory groups, State Street stated in its July 26 letter that “[w]e” [SSgA] believe that events in the subprime market are “more driven by liquidity and leverage issues than long term fundamentals,” thereby suggesting that *all* of State Street was staying the course. This omission caused certain investors to maintain their holdings in an increasingly volatile and illiquid market environment.

21. These misleading statements also failed to alert investors to another market reality-- State Street was selling LDBF's most liquid holdings and using the cash it received

from these sales to meet the redemption demands of the advisory group clients—thus leaving the remaining investors with largely illiquid holdings.

22. Between July 26 and August 1, State Street raised almost \$700 million in cash to meet anticipated investor redemption demands. Approximately 75 percent of this cash came from the sale of almost all of LDBF's highest rated AAA bonds, even though LDBF's AAA bonds were only 20 percent of LDBF's net asset value before the issuance of the July 26th letter. State Street depleted the cash it raised from the sale of LDBF's highest rated assets at a much faster rate than it sold LDBF's lower rated bonds, resulting in a fund that held bonds of lower average credit quality and highly illiquid holdings for investors who remained in the fund after the anticipated redemptions. After receiving State Street's subprime update on July 26, investors relying on State Street's written materials still had no idea they were in a subprime concentrated fund, or that the fund would soon be concentrated in its lower-rated subprime bonds.

23. On about August 2, 2007, State Street sent another uniform letter to all affected customers invested in the Funds. This letter, though providing preliminary July 2007 performance results, did not disclose other material information relevant to customers' investment decisions. Specifically, the August 2 letter focused on the BBB tranche of the ABX index and its impact on LDBF, but did not disclose the full extent of each Fund's exposure to the subprime market generally or to LDBF. The August 2 letter also did not disclose the extent of each fund's subprime holdings (which accounted for virtually all of that fund's losses), nor did the letter reveal the degree of leverage in each fund.

24. Moreover, in the August 2 letter, State Street again stated it had taken actions to reduce risk, including the sale of certain subprime bonds, while maintaining LDBF's average credit quality. However, State Street had sold almost all of the LDBF's highest rated subprime

bonds, and, upon meeting anticipated investor redemptions in late July and early August, the LDBF's bonds were increasingly lower credit quality. Those investors who remained in the dark concerning the LDBF's risks invested in or continued to hold their investment as LDBF became concentrated in lower-rated subprime bonds

25. Rather than fully disclose such material facts regarding State Street's subprime holdings, the August 2 letter merely continued to state that "[w]e" [SSgA] believe that events in the subprime mortgage market have been "more driven by liquidity and leverage issues than long term fundamentals." This statement continued to mislead investors and omitted the fact that just days before, all of its own advisory groups that were invested in the Funds had begun to contact clients to recommend full liquidation. As noted in ¶20, *supra*, OFA and GAA began such notifications during the last full week of July. They were joined by the Charitable Asset Management ("CAM") advisory group on July 30th, when CAM began contacting clients to recommend that they liquidate from the Funds. The recommendations of these advisory groups resulted in numerous client redemptions from the Funds.

26. Further, State Street had clearly considered whether to include information about the advisory group liquidations in the August 2nd letter, but chose not to put the information in the letter nor to allow other written communications from State Street to include the same information. In one instance, State Street executives responded to a request by an RM to disclose the GAA decision in the August 2 letter (to be sent to his client, the Town of Arlington) by stating that any reference to the GAA decision should be omitted in all written communications with clients. State Street issued and carried out this directive, even though the Town of Arlington was *itself* a GAA client.

27. Significantly, the State Street Retirement Plan, which included investments by State Street executives and other employees, was contacted by OFA on July 31, 2007 and urged to liquidate out of the Bond Market Non-Lending Fund. The State Street Retirement Plan sold all their holdings soon thereafter (on August 3), even as State Street continued to issue statements to many outside customers suggesting that “we” believe in the fundamentals of the subprime market.

28. On about August 14, 2007, a State Street executive sent an additional letter to certain affected investors who remained invested in the Funds. The August 14 letter again served to reassure investors about their subprime holdings, stating that “[w]e” [SSgA] believe that “many judicious investors” will hold their positions in the subprime market. This statement continued to mislead investors and omitted the fact that, as noted *supra*, all of SSgA’s own advisory groups that were invested in the Funds had begun to contact clients to recommend full liquidation. Further, the August 14 letter failed to disclose additional material details regarding State Street’s subprime investments, including the extent of the Funds’ exposure to the subprime market and the degree of leverage held in the Funds.

29. On about October 5, 2007, another State Street executive sent an additional letter to affected customers that remained invested in the Funds. As with prior letters, the October 5 letter failed to disclose material facts regarding the funds’ subprime holdings, stating, instead, that *client redemptions* had led State Street to sell “unimpaired assets” into an illiquid market; the letter stated:

Unfortunately, due to certain client redemptions, we were obligated to sell otherwise unimpaired assets into a market which was largely illiquid creating realized losses. These redemptions were a contributing factor in the negative returns. They were not the result of any failure on the part of SSgA’s investment management.

These statements failed to disclose that State Street's own risky investments had led to losses in the Funds, and further concealed the extent to which State Street's subprime holdings continued to pose a risk of future devaluations in the Funds.

30. Not only did State Street issue statements including the foregoing misrepresentations and omissions, but beginning at least the end of July 2007, State Street's top executives approved and implemented a procedure by which State Street would respond to investor questions based on previously drafted responses to "Frequently Asked Questions" (or "FAQs"). These FAQ responses included detailed information about the Funds' holdings, including specific percentages held in the subprime market; one of the responses revealed that the GAA group had recommended a move from the Funds into "passive" fixed income strategies. Yet, State Street executives failed to make this information available to all affected investors by designating the FAQ responses as "Internal Use Only," and directing that RMs convey these responses orally and *only* upon request by investors. This procedure continued to result in the vastly differential treatment of investors, which was a breach of State Street's duty, as fiduciary and trustee, to treat similarly situated investors fairly and impartially.

31. As a result of State Street's misrepresentations and omissions, numerous investors suffered losses in their AFI investments. A total of about 270 customers were invested in the Funds in 2007, including about 50 investors based in Massachusetts. The affected investors included charities, nonprofit organizations, universities, pension systems, and certain political subdivisions of the Commonwealth of Massachusetts.

32. At all relevant times, State Street conceived of, approved, and carried out its actions as described herein in the Commonwealth of Massachusetts, issuing misrepresentations

and omissions and committing unfair and deceptive practices against customers located both in Massachusetts and throughout the United States. As of the date of this Complaint, and based on the market values of their holdings in the Funds, affected investors have suffered over \$300 million in outstanding losses.

CAUSES OF ACTION

Count One (Violation of G.L. c. 93A, § 4)

33. The Commonwealth incorporates by reference the allegations of all prior paragraphs of the Complaint.

34. Defendant engaged in unfair and deceptive acts or practices in the course of providing investment management products and services in Massachusetts, including those provided to certain political subdivisions of the Commonwealth.

35. Defendant's unfair and deceptive acts or practices include, but are not limited to:

- a) Failing to disclose the nature and extent of each Fund's exposure to the subprime market, either directly or through its holdings in LDBF;
- b) Failing to disclose the nature and extent of each Fund's exposure to derivatives, including the degree of leverage in each Fund;
- c) Failing to disclose the fact that each Fund's losses were almost exclusively attributable to State Street's subprime investments;
- d) Failing to disclose, at the time of State Street's July 26th, August 2nd, and August 14th letters to investors regarding the status of the Funds' investments, that internal advisory groups had recommended liquidation

from these Funds and had begun to contact clients regarding this recommendation; and

- e) Engaging in differential treatment of investors by failing to provide uniform and adequate disclosures to all affected customers invested in the Funds.

36. Defendant's misrepresentations and omissions concerning the Funds were material.

37. Defendant knew, or should have known, that they were committing actions that were unfair and deceptive in violation of G.L. c. 93A, § 2(a).

38. The customers invested in the Funds in 2007 suffered harm as a result of Defendant's unfair and deceptive conduct, including but not limited to substantial losses in the value of the Funds and the loss of opportunity to invest in other investment vehicles that were consistent with the customers' investment objectives.

39. State Street has agreed to waive the Commonwealth's notice requirement pursuant to G.L. c. 93A, § 4.

Count Two
(Violation of G.L. c. 12, § 5B)

40. The Commonwealth incorporates by reference the allegations of all prior paragraphs of the Complaint.

41. Political subdivisions of the Commonwealth invested in State Street's Funds and paid management fees to State Street. The Attorney General brings this action under G.L. c. 12, § 5B and alleges, in regards to such invested monies and fees, that Defendant with actual

knowledge of relevant information or with deliberate ignorance of the truth or falsity of the information or with reckless disregard of the truth or falsity of the information:

- a) Presented, or caused to be presented, false or fraudulent claims for payment or approval;
- b) Used false statements to obtain payment or approval of claims;
- c) Entered into an agreement or understanding pertinent to G.L. c. 12, § 5B; and
- d) Failed to disclose the false claims to the Commonwealth, even though State Street was a beneficiary of the submission of such false claims.

42. Defendant, by and through its agents, misrepresented and omitted material information concerning the nature and risks of State Street's subprime investments, including, *inter alia*, the extent of subprime exposure and use of leverage in the Funds, causing publicly invested monies to remain in the Funds and resulting in the payment of additional investment management fees to SSgA. Such actions caused the payment of monies from, and/or the loss of value in, the Funds in which public monies were invested.

RELIEF REQUESTED

WHEREFORE, the Commonwealth requests that this Court:

- a) Enter judgment in its favor, and against Defendant for such damages and restitution as are available pursuant to G.L. c. 12, § 5B, G.L. c. 93A, § 4;
- b) Order Defendant to pay civil penalties as provided for under G.L. c. 93A, § 4 and under G.L. c. 12, § 5B;

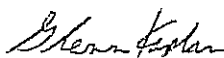
- c) Order Defendant to disgorge all ill-gotten gains under G.L. c. 93A;
- d) Order Defendant to pay the Commonwealth the costs of investigation and litigation, including attorneys' fees, pursuant to G.L. c. 93A, § 4 and G.L. c. 12, § 5B;
- e) Grant such other and further relief to remedy, address, and prevent additional harm arising from Defendant's actions as the Court deems equitable and proper.

Respectfully Submitted,

COMMONWEALTH OF MASSACHUSETTS
MARTHA COAKLEY
ATTORNEY GENERAL

Dated: February 4, 2010

By: _____


Glenn Kaplan, BBO #567308
Amita Singh, BBO #671120
Assistant Attorneys General
Insurance & Financial Services Division
Public Protection & Advocacy Bureau
One Ashburton Place, 18th Floor
Boston, MA 02108
(617) 727-2200