

Stung by subprime mess, investors head to court

Local litigation targets Morgan Keegan & Co.

By Cory Schouten

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Indianapolis Business Journal (IN) - Angry investors in Indiana and across the country are going to court to recover some of the billions of dollars they've lost on investments connected to subprime mortgages. Mortgage-backed investments have appeared on the balance sheets of companies and organizations large and small. And observers say write-downs totaling \$100 billion at firms like Merrill Lynch, UBS and Bear Stearns are just the beginning. Various law enforcement agencies, including the FBI, are investigating whether investors were misled.

"This crisis will affect more investors than any other," said Fishers attorney Tom Hargett, a partner at Maddox Hargett & Caruso, a firm that specializes in recovering assets lost to investment fraud and negligence. "Public and private pension funds, mutual funds and other funds will experience significant losses."

The legal fights already have begun in Indianapolis.

Locally based CountryMark Cooperative late last month sued its investment adviser, Morgan Keegan & Co., for directing the farmer-owned co-op toward a \$10 million investment in mortgage-backed securities, including subprime. CountryMark purchased its note on Aug. 10, 2007. Seven days later, ratings agencies downgraded the A+-rated investment to junk status. It remains in default.

The Indiana Children's Wish Fund also fought Memphis-based Morgan Keegan over investment losses. The charity lost about \$48,000 after an adviser suggested the group invest \$223,000 in an intermediate-bond fund in June 2007. The fund, which included mortgage-related securities, fell 22 percent before the Wish Fund yanked its investment. The group eventually recovered its loss after filing an arbitration claim.

The state of Massachusetts charged Merrill Lynch with fraud this month, even after the investment bank agreed to refund \$14 million to the city of Springfield. Merrill sold the city collateralized debt obligations that quickly lost most of their market value. The city of Cleveland sued 21 banks that issued subprime loans, arguing they should have to help the city deal with a rapid rise in foreclosures.

Many more lawsuits are expected, as losses mount. From 2001 to 2006, banks pooled more than \$5 trillion in high-risk mortgages into investments that won triple-A ratings in a bit of "hocus pocus," Hargett said. About 25 percent of those mortgages now are in trouble.

Hargett, a former stockbroker, believes many bond fund managers still are hiding behind "theoretical values"-meaning some investors still don't know the true extent of their losses.

Ken Skarbeck, managing partner of Indianapolis investment firm Aldebaran Capital, agrees. There are more "dominoes to fall" in the credit mess, he said, likely to the tune of another \$150 billion in losses.

Skarbeck finds it "distasteful" that banks were hawking pools of mortgages of questionable quality to their clients, but he knows why they did it: The fees for selling the investments were lucrative.

"I don't know whether 'buyer beware' is an adequate protection on this stuff," Skarbeck said. "Frankly, the guys putting these things together and selling them don't even know what they are. To think someone at CountryMark understood what they bought is far-fetched. There's going to be a lot of litigation."

CountryMark is suing Morgan Keegan, a division of Alabama-based Regions Financial Corp., to recover the purchase price of its investment, along with interest and attorney's fees.

In the suit, filed in U.S. District Court in Indianapolis, the company says Morgan Keegan failed to disclose that the investment was substantially backed by subprime and midprime mortgages—a risky bet that ran counter to the co-op's investment objective.

"We have been let down by Morgan Keegan in so many ways," Charlie Smith, CountryMark's CEO, said in a statement.

A spokeswoman for Morgan Keegan said the company was merely a middleman in the transaction, selling a "Golden Key" security underwritten by Merrill Lynch.

"The commercial paper at issue in this suit had the highest available commercial paper rating 'A-1+' by Standard & Poor's," said Kathy Ridley, in an e-mailed statement.

"Morgan Keegan acted only as a distributor in this transaction, buying the securities from Merrill Lynch, who was the underwriter, and then reselling them to CountryMark. Shortly after the sale, this issue defaulted, a rare and unexpected occurrence with such a highly rated issue."