
Subprime suits' next targets may be funds

Plaintiff's attorneys assessing liability of fund managers

By **David Hoffman**
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Mutual fund companies largely have been immune to lawsuits stemming from the subprime-mortgage crisis, but that soon may change.

Plaintiff's attorneys are starting to look beyond the mortgage companies that originated subprime loans, and the banks and brokerage firms that allegedly failed to disclose their exposure to subprime investments adequately, in an effort to recover more money for investors.

"I think mutual fund managers who purchased collateralized debt obligations [which held subprime-mortgage debt] in their conservative portfolios, if they overconcentrated their portfolios in this stuff, have all kinds of liability," said Thomas A. Hargett, a partner with Maddox Hargett & Caruso PC of Fishers, Ind.

His firm was part of a group of four firms that issued a press release Jan. 9 announcing that they were "investigating" losses alleged to have occurred as a result of subprime exposure in mutual funds offered by Memphis, Tenn.-based Morgan Keegan & Co., a subsidiary of Regions Financial Corp.

Their investigation was spurred by a class action filed on Dec. 6 against Regions and its affiliates in the U.S. District Court for the Western District of Tennessee.

It's the first such suit having to do with subprime losses in mutual funds, and mutual fund insiders fear it may not be the last.

The suit alleges Regions and its affiliates misrepresented and omitted material information from fund registration statements and prospectuses concerning investments in collateralized debt obligations and the resulting exposure to the subprime-mortgage market.

PRECIPITIOUS FALL

That Mr. Hargett and others smell blood in the water is cause for concern, said William Sullivan, a partner and chairman of the national securities litigation group with Paul Hastings Janofsky & Walker LLP of Los Angeles.

"It's something we have to keep an eye on," he said.

It's possible that mutual fund companies could cast themselves as the victims, and bring litigation against some of the



Andrew Stoltmann: This is just the tip of the iceberg.

same mortgage lenders, banks and brokerages already facing legal action, Mr. Sullivan said.

But it's much more likely that they will find themselves the targets of legal action, he said.

No funds suffered losses attributable to subprime exposure as much as Regions Morgan Keegan Select Funds, particularly the Regions Morgan Keegan Select High Income Fund, said Paul Herbert, a fund analyst with Morningstar Inc. of Chicago.

That fund finished 2007 down 59.7%, placing it in the 99th percentile of its high-yield bond fund category, according to Morningstar. That's a precipitous fall from 2006 when it finished up 11.1%, placing it in the 25th percentile of its category.

LONG ARM OF THE LAW

Other fund companies are vulnerable to legal action as well, Mr. Herbert said.

Two firms in particular — State Street Global Advisers and Fidelity Investments, both of Boston — offer funds that saw big drops as a result of subprime investments, Mr. Herbert said.

Indeed, it appears SSgA is anticipating being sued. It has established a reserve of \$618 million "to address legal exposure and other costs associated with the underperformance of certain active fixed-income strategies," SSgA announced on Jan. 3.

The SSgA Yield Plus Fund was down 13.4% at the end of last year, placing it in the 100th percentile of its ultrashort bond fund category, according to Morningstar. It finished 2006 up 5%.

The Fidelity Ultra-Short Bond Fund was down 5.1% at the end of last year, placing it in the 96th percentile of the ultrashort bond category, according to Morningstar. It was up 4.9% in 2006.

BAD AND GETTING WORSE

"Conditions are ripe" for legal action arising from fund exposure to subprime investments, and the industry is concerned, said Jeff Keil, president of Keil Fiduciary Strategies LLC, a Littleton, Colo.-based industry consulting firm.

Securities class-action filings involving financial companies of all stripes increased 43% in 2007, to 166 filings, from 116 filings in 2006, according to a report issued at the end of last year by the Stanford Law School Securities Class Action Clearinghouse, based in Palo Alto, Calif., in cooperation with Boston-based Cornerstone Research.

Much of that increase is attributable to the subprime crisis.

The report estimated that 32 financial institutions were facing class actions filed as a result of the subprime mess.

Since the report was released, three more subprime-related class actions have been added to the list.

And it's only going to get worse, according to industry experts.

Companies that already have been hit with subprime-related suits, such as New York-based Merrill Lynch & Co. Inc. and Citigroup Inc. — both of which are accused of misleading investors about their firms' subprime exposure — are among those that can expect to be hit with additional suits, said Andrew Stoltmann, a plaintiff's attorney and partner in Stoltmann Law Offices PC in Chicago.

Others that have only been involved peripherally, such as Wachovia Corp. of Charlotte, N.C., can expect to be the target of suits in which they are the principal subject, said Mr. Stoltmann, who is himself involved in several current subprime suits.

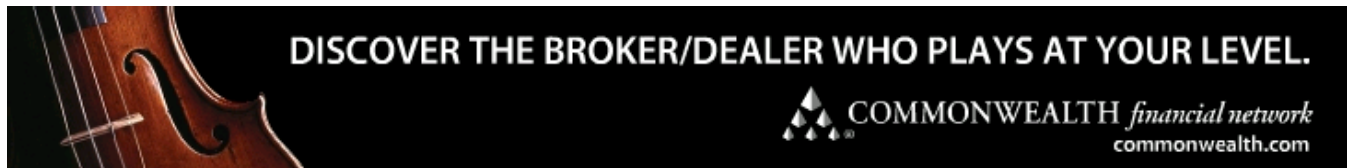
"This is just the tip of the iceberg," he said. "There are a lot of investors out there that don't even realize they have suffered loses."

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Jeff Keil: "Conditions are ripe" for subprime legal against funds.

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