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Global Finance: Moody's Cuts Bank Ratings

By Julie Steinberg and Andrew R. Johnson
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English

Moody's Investors Service downgraded the senior holding-company debt ratings of several big U.S. bank holding companies, reflecting the agency's belief that there is an increased likelihood the government wouldn't support them in the event of a crisis.

Moody's downgraded by one notch the holding-company ratings of Morgan Stanley, Goldman Sachs Group Inc., J.P. Morgan Chase & Co. and Bank of New York Mellon Corp., the rating company said Thursday. It held steady the holding-company ratings of Bank of America Corp., Citigroup Inc., State Street Corp. and Wells Fargo & Co.

Morgan Stanley, Goldman and BNY Mellon declined to comment. J.P. Morgan couldn't be reached for comment.

The review of the banks' credit ratings began in August. The agency said then it was putting the holding-company ratings on watch as more details became clear about the government's approach for unwinding the banks in the event of a crisis.

In June 2012, Moody's downgraded the credit ratings of 15 global banks, including a two-notch cut for Morgan Stanley and three-notch downgrade for Credit Suisse. The ratings firm cited recent global economic turmoil, challenges facing the U.S. housing market and other factors.

In that downgrade, Moody's was focusing on the banks' fundamentals, including its financial strength, said David Fanger, a senior vice president at Moody's.

Thursday's actions focus on the level of support that can be expected from the government and whether any support would come at a cost for bondholders.

Tess Stynes contributed to this article.

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Markets
State Street Revenue Disappoints Investors

Saabira Chaudhuri
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State Street Corp.'s third-quarter revenue disappointed investors Tuesday, pushing the bank's shares down as revenue and margins were squeezed by continued low short-term interest rates.

Shares dropped about 4.3% to $66.81 in recent trading as revenue missed the estimates of analysts polled by Thomson Reuters.

Net interest revenue plunged 12% from a year ago and 8.4% from the second quarter to $546 million. Overall revenue grew 3% from a year earlier, although it fell roughly 5% from the second quarter, to $2.43 billion. Analysts polled by Thomson Reuters had most recently forecast revenue of $2.51 billion.

On a conference call, Chief Financial Officer Michael W. Bell said he expected "net interest revenue to continue to be under pressure until short-term rates begin to rise."

In addition to the low interest-rate environment, Chairman Joseph L. Hooley said the quarter was "impacted by the cyclical declines in market-driven revenue from a summer slowdown."

State Street in recent weeks said it had seen a surge in deposits as investors prepared for a possible U.S. default. However, the bank said in recent days the excess deposits have receded after a deal to suspend the debt ceiling through Feb. 7.

The company reported a profit of $531 million, or $1.17 a share, down from $654 million, or $1.36 a share, a year earlier. The year-ago quarter included a tax benefit of 35 cents a share, primarily for recoveries associated with the 2008 Lehman Brothers bankruptcy.

On an operating basis, per-share earnings rose to $1.19 from 99 cents. Analysts had expected earnings of $1.18 a share.

However, several analysts said that, stripping out a separate $19 million gain logged during the third quarter from the sale of a Lehman Brothers-related asset, State Street's per-share earnings were in fact about two cents below consensus estimates.

State Street's earnings report comes after rival Bank of New York Mellon Corp. last week reported its third-quarter income rose 35% amid a boost from a recent tax-court decision. But BNY Mellon's expenses rose, cutting into earnings growth as revenue growth remained sluggish.

Josh Levin, an analyst at Citigroup, said State Street's net interest margin, assets under custody, operating expenses and core per-share earnings were all lower than he had expected.

On an adjusted basis, the net interest margin–a key measure of lending profitability–narrowed to 1.27% from 1.44% a year earlier and 1.31% in the prior quarter.

Mr. Bell on the call noted that State Street primarily invests in shorter-term securities, so the bank doesn't expect the rise in long-term rates to affect it much. Still, the bank gave a slightly more optimistic view about net interest margins for the fourth quarter, saying it expects a slight seasonal uptick in net interest revenue and hence margins.

State Street's assets under management at the end of the quarter rose 8.5% to $2.24 trillion from a year ago. Trading-services revenue dropped 14% from the second quarter to $256 million as the firm saw falling volumes. But this grew 10% from the year-ago quarter.

The company said its fee revenue was squeezed by lower volumes and as clients took less risk amid uncertainty about when the Federal Reserve would decide to taper its asset purchases. State Street saw some flows out of its fixed-income business into equity funds, but added that it experienced significant flows into money market funds, which led to an increase in money market fee waivers.

The company remains on track to see $220 million in pre-tax cost savings this year from a new technology program, and about $600 million by 2015. In the third quarter, State Street's expenses of $1.72 billion were up 22% from the third quarter of 2012, although down 4.2% from the second quarter.

Mr. Bell described the bank's expenses as "well controlled in the third quarter", noting that compensation and benefits expense was down 1.4% and 1.5% from the year-ago and second quarter, respectively.

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THE WALL STREET JOURNAL.

Special

Bond ETFs That Use Fundamental Indexing Are Off to Slow Start; So far, the four bond ETFs that use fundamental indexing have attracted only a small sliver of investor dollars

Carolyn Cui
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"Fundamental" indexing, which has gained traction with stock investors, is off to a slower start in the world of bond funds.

There are just four exchange-traded bond funds of this ilk, with combined assets of $724 million, according to IndexUniverse, an ETF data provider. Most of the assets are in the $653 million PowerShares Fundamental High Yield Corporate Bond ETF.

As with fundamental indexing for stocks, the idea is to weight the securities in a portfolio by measures of issuers' financial health rather than by the market value of securities outstanding.

Because standard bond indexes assign weights based upon debt outstanding, critics say this could lead to an overweight of heavily indebted companies and expose investors to higher credit risk. These concerns were further fueled as the sovereign debt crisis flared in Europe, triggering a flight away from the most-indebted countries.

In 2010, the PowerShares junk-bond ETF switched from a traditional benchmark to an index developed by Research Affiliates LLC that weights bonds according to companies' book value, sales, dividends and cash flow. "You end up with a tilt toward companies with strong fundamentals and greater ability to make payments on their debt," which makes the portfolio safer, says Shane Shepherd, head of fixed-income research at Research Affiliates.

The PowerShares junk-bond ETF doubled in size after the switch. But three years later, the fundamental bond-index sector is still a tiny niche in the $250 billion U.S. bond-ETF market.

Invesco Ltd.'s PowerShares unit runs two of the other three fundamentally weighted bond ETFs: the $32 million PowerShares Fundamental Investment Grade Corporate Bond, launched in 2011, and the $9 million PowerShares Fundamental Emerging Markets Local Debt, introduced in May.

State Street Corp.'s State Street Global Advisors, meanwhile, launched SPDR Barclays Issuer Scored Corporate Bond in 2011. The $31 million ETF tracks a Barclays index that weights issuers by financial ratios such as return on assets, interest coverage and current ratio.

The sector's slow growth reflects the fact that bond ETFs didn't hit the market until 2002, as well as competition from active managers. WisdomTree Investments Inc. uses fundamental factors in selecting bonds for a series of actively managed ETFs that have attracted more than $2 billion since 2010.

Performance has also been a drag for fundamental bond indexing. The PowerShares junk-bond fund has been trailing the $8.9 billion market-cap-weighted SPDR Barclays High Yield Bond. During the three years through August, the PowerShares ETF gained an annualized 7.5% compared with 9.0% for the SPDR ETF. Through the first eight months of this year, the PowerShares fund was up 0.6% versus a 1.0% gain for the SPDR.

To some degree, the return shortfall is a trade-off for holding better-quality bonds, as firms with lower credit ratings tend to offer higher yields. About 70% of the PowerShares junk-bond fund's holdings are rated BB or higher, compared with 37% for the SPDR fund. The PowerShares fund has a weighted average coupon of 6.5%, versus 7.2% for the SPDR.

Lower-rated bonds have outperformed safer bonds this year, as investors are willing to take on more risk. "That's the primary reason for our underperformance of late," says Joe Becker, senior income product strategist at Invesco PowerShares.

Still, some skeptics question the wisdom of fundamental weighting. Some heavy issuers are still able to borrow at low yields, suggesting there's a weak link between debt load and bond returns. For example, Japan has the highest debt-to-GDP ratio among all developed countries, but yields on its government bonds are among the lowest.

Another caveat is that these funds aren't as liquid as those weighted by market value. "They tend to hold a greater quantity of less-liquid bonds, so trading can be a concern," says Gene Koyfman, vice president of research at IndexUniverse.

Nevertheless, some analysts believe fundamental bond indexes may shine as interest rates climb. Heavily indebted companies are likely to struggle more in times of higher rates: As they try to roll over maturing debt they have to pay higher costs, increasing their default risk.

In this scenario, fundamentally weighted funds might outperform, as they tilt toward issuers best suited to service their debt, analysts say.

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Opinion
Rahm Ignored the Warnings

Allysia Finley
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English

It's never a good sign when a city's ex-comptroller is indicted for corruption. However, it's particularly worrisome for Chicago, which has enough financial problems that it knows about to fix.

Last week a federal grand jury indicted Amer Ahmad on eight counts of corruption related to his old jobs as Ohio's deputy treasurer and CFO. The charges include money laundering, conspiracy, bribery, wire fraud and making false statements.

Chicago Mayor Rahm Emanuel hand-picked Mr. Ahmad to serve as city comptroller despite Ohio newspaper reports that he had engaged in suspect transactions during his tenure in the state treasurer's office. To wit, he had steered state business to the Boston-based State Street Bank, where his personal friend Mohammed Noure Alo worked as a lobbyist. Then-Democratic treasurer Kevin Boyce later hired Mr. Alo's wife in his office.

There's more. According to the indictment, Mr. Ahmad had also directed security trades to investment broker Douglas E. Hampton, a high school classmate who had served as his investment advisor since 1996. Mr. Hampton in turn sent $400,000 in kickbacks, er, "loans" to a landscaping business in which Mr. Ahmed owned a stake. The broker also paid $123,000 in "legal fees" to Mr. Alo, who was also indicted.

After Mr. Boyce lost the treasurer's race in November 2010, Mr. Ahmad went to work for the bank KeyCorp, whose banking division had received a lucrative state checking contract. In May 2011, Mr. Emanuel tapped Mr. Ahmad as comptroller. The two men had worked at the investment house Wasserstein Perella & Co. in the late '90s.

After Mr. Ahmad tendered his resignation last month, supposedly as part of a normal mid-term rotation, the mayor praised his fellow Wasserstein alum for playing "an integral role in my efforts to reform government, strengthen the city's finances and professionalize our approach to fiscal management."

Mr. Emanuel's office says they were blind-sided by the indictment, and perhaps they were. But if that's true, there's probably a lot more funny business that Mr. Emanuel doesn't know about. On the other hand, maybe Mr. Ahmad's schemes are just par for the course in Chicago and didn't faze the mayor.

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Markets

State Street Earnings Rise 19%; Higher Servicing, Management Fees Cited as Boost to Earnings

By Melodie Warner
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English

State Street Corp.'s second-quarter earnings rose 19% as the trust bank collected more servicing and management fees.

State Street, one of the country's largest trust banks, has taken a hard line on expenses despite improving business trends. The company's cost-control measures have included withdrawing from its fixed-income-trading initiative and staff cuts, actions it has said will better align expenses with its 2013 business outlook.

State Street also bought Goldman Sachs Group Inc.'s hedge-fund administration business for $550 million in October, a deal that makes State Street the biggest manager of behind-the-scenes activities for hedge funds, such as tax reporting and accounting.

State Street reported a profit of $571 million, or $1.24 a share, up from $480 million, or 98 cents a share, a year earlier. Excluding items such as equity-incentive-compensation expense, adjusted per-share earnings rose to $1.24 from $1.01. Revenue jumped 5.8% to $2.56 billion.

Analysts polled by Thomson Reuters had most recently forecast earnings of $1.19 a share on revenue of $2.54 billion.

Servicing fees rose 11% to $1.2 billion. Trading-services revenue, which includes foreign-exchange trading revenue and brokerage and other fees, declined 0.8% to $125 million.

Management fees increased 13% to $277 million and securities-finance revenue dropped 8.4% to $131 million.

Assets under management as of June 30, rose 12% to $2.146 trillion from $1.908 trillion a year before, while assets under custody and administration increased 15% to $25.742 trillion from $22.423 trillion.

Moody's Investors Service recently placed State Street's A1 investment-grade rating on review for a possible downgrade because of profitability challenges from aggressive pricing of its core custody products and services. The credit ratings company is also reviewing its long-term debt ratings for rival trust and custody banks Bank of New York Mellon Corp. and Northern Trust Corp.

On Wednesday, Bank of New York Mellon reported its second-quarter earnings rose 81% with the help of an equity investment gain and a 14% rise in fee revenue. Meanwhile, Northern Trust's second-quarter profit rose 6.4% as higher fees helped offset weaker net interest income.

State Street shares closed Thursday at $70.10 and were inactive premarket. The stock has risen 49% so far this year.

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Dell Buyout Pushed to Brink

By Shira Ovide, Sharon Terlep and David Benoit
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English

Dell Inc.'s $24.4 billion buyout plan was foundering late Wednesday evening, as a group of big investors signaled their intent to vote against a deal that would remove the technology icon from the public markets.

The new opposition from Vanguard Group Inc., State Street Corp. and BlackRock Inc. pushed the deal to a new level of brinkmanship, forcing Michael Dell and his backers to either sweeten the transaction or risk seeing the deal fail.

Late into the night Wednesday, Mr. Dell and his namesake company and their advisers were weighing how to respond to the latest developments. People involved in the transaction said they were expecting to delay a scheduled July 18 shareholder vote on a plan that would award Dell holders $13.65 a share.

Dell shares continued to slip at the prospect of a no vote, falling 1.1% on the day to $12.88 each. The movement raised the stakes for the buyers to either raise their bid or call the bluff of some investors pressing for a higher share price and walk away from an offer they spent months putting together.

Representatives for Vanguard and State Street declined to comment. A BlackRock representative didn't respond to a request for comment. CNBC earlier reported on Vanguard and BlackRock's leanings.

That opposition would bring the count of known planned negative votes to close to 30% of Dell shareholders.

Brinkmanship over deal prices isn't unusual, but it is rare for large deals to fail in stockholder elections. Since 2005, shareholder votes defeated just 14 of more than 1,600 U.S. corporate takeovers tracked by research firm FactSet Shark Repellent.

A delay would be a setback for Mr. Dell and his partner in the deal, Silver Lake, who in February agreed to buy the struggling computer maker. Within days, the offer met resistance from some big shareholders, who over the course of the last few months appear to have succeeded in convincing other big investors to at least push for more money.

Carl Icahn, the largest shareholder after Mr. Dell and the deal's most-vocal detractor, late Wednesday said of the vote: "Obviously we have some insights and we feel pretty good," while speaking at CNBC's Institutional Investor Delivering Alpha conference.

On Wednesday, some people familiar with board deliberations said a likely outcome was to start -- and then seek to adjourn -- the formal stockholder vote Thursday morning at Dell's Round Rock, Texas, headquarters. For legal reasons, when trying to sway shareholders to change their minds, it is simpler to adjourn a corporate election than to delay it ahead of time, one person familiar with Dell said. A delay would then last a few days or a week, they said.

A vote delay could be avoided amid last-minute negotiations. And even if a vote were delayed, that wouldn't mean the buyout is dead. A pushback of several days could give Mr. Dell and Dell's board time to try to convince shareholders to change their votes, to push stockholders who didn't vote to cast their ballots or to bump the price to try to win over more shareholders.

Some people close to the special committee and buyout group believed at least some of the shareholders are opposing the sale for now to push for a higher sale price.

Mr. Dell and Silver Lake have sought to spread the message they won't pay any more and are fine with letting the sale fall apart. The delayed vote sets up a waiting game over which side will blink first. Shareholders can change their position until the very end.

Mr. Dell and stockholders opposing his sale each generally agree that Dell must move quickly to shed its origins as a PC maker, and turn the company into a broad seller of computing gear, software and other services for corporations. The disagreement is over whether Mr. Dell is the right person to lead the transformation, whether $13.65 a share is a fair price and whether current shareholders are being cheated out of potential future gains if Dell's transformation is successful.

Mr. Dell, who founded the company in his college dorm room nearly 30 years ago, has staked his reputation and billions of dollars of his fortune on buying control of Dell from stockholders, and nursing the company back to health.

If the Dell deal collapses, it would be one of the biggest corporate buyout failures and could put Mr. Dell's role in the company in jeopardy. Mr. Icahn has pledged to oust Mr. Dell as chief executive and to seek removal of Dell's board.

A delay also wouldn't bode well for the Round Rock, Texas company, which has been trying to conduct business while shareholders, analysts and others debate the merits of its future. To convince shareholders the offer was fair, the special board committee that negotiated the deal has been beating a drum that Dell's prospects are poor and any revival is risky.

Dell's stock price is almost certain to drop if the buyout falls apart, though investors and participants in the deal have debated by how much. On the other hand, as investors have absorbed the possibility of a defeated deal in recent days, the stock price hasn't collapsed.

Dell shares were trading below $9 each last fall, after a string of financial results that had disappointed investors. The stock price was above $18 as recently as February 2012.

The outcomes for a company can be unpredictable when a corporate sale vote fails. Stockholders rejected a 2011 buyout offer for electricity producer Dynegy Inc., and Dynegy's holding company filed for bankruptcy protection within months. In 2010, stockholders of car-rental chain Dollar Thrifty Automotive Group Inc. voted down a $1.5 billion sale to Hertz Global Holdings Inc., in face of interest from a rival bidder. Two years later, Dollar Thrifty agreed to a sale to Hertz at more than double the 2010 sale price.

Joann S. Lublin contributed to this article.

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Tech
Dell Buyout Pushed to Brink; Large Shareholders Expected to Reject Deal

By Shira Ovide, Sharon Terlep and David Benoit
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Dell shares continued to slip at the prospect of a no vote, falling 1.1% on the day to $12.88 each. The movement raised the stakes for the buyers to either raise their bid or call the bluff of some investors pressing for a higher share price and walk away from an offer they spent months putting together.

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If the Dell deal collapses, it would be one of the biggest corporate buyout failures and could put Mr. Dell's role in the company in jeopardy. Mr. Icahn has pledged to oust Mr. Dell as chief executive and to seek removal of Dell's board.

A delay also wouldn't bode well for the Round Rock, Texas company, which has been trying to conduct business while shareholders, analysts and others debate the merits of its future. To convince shareholders the offer was fair, the special board committee that negotiated the deal has been beating a drum that Dell's prospects are poor and any revival is risky.

Dell's stock price is almost certain to drop if the buyout falls apart, though investors and participants in the deal have debated by how much. On the other hand, as investors have absorbed the possibility of a defeated deal in recent days, the stock price hasn't collapsed. That has lent some credence to the view of deal dissidents that a failed sale wouldn't crush Dell's stock price.

Dell shares were trading below $9 each last fall, after a string of financial results that had disappointed investors. The stock price was above $18 as recently as February 2012.

The outcomes for a company can be unpredictable when a corporate sale vote fails. Stockholders rejected a 2011 buyout offer for electricity producer Dynegy Inc., and Dynegy's holding company filed for bankruptcy protection within months. In 2010, stockholders of car-rental chain Dollar Thrifty Automotive Group Inc. voted down a $1.5 billion sale to Hertz Global Holdings Inc., in face of interest from a rival bidder. Two years later, Dollar Thrifty agreed to a sale to Hertz at more than double the 2010 sale price.

Joann S. Lublin contributed to this article.

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Markets
U.K. Investigating Currency Exchange Rates

By Margot Patrick
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English

LONDON—The U.K. financial regulator is gathering information on potential manipulation of benchmark foreign-exchange rates, amid new allegations that traders at banks are rigging rates to boost profits.

The Financial Conduct Authority said it was looking into the matter on Wednesday after Bloomberg News earlier reported that employees at unidentified banks were allegedly front-running client orders and rigging a widely used set of foreign-exchange rates by pushing through trades before and during the 60-second windows when the benchmarks are set, citing dealers with knowledge of the practice.

Bloomberg said dealers colluded with other dealers at other banks to boost the chances of moving the rates, according to two of the unnamed people cited in the story.

The trade data behind the rates are collected and distributed by World Markets Co., part of State Street Corp. Thomson Reuters Corp. contributes trading data and has a co-branding agreement on the benchmarks.

"The FCA is aware of these allegations and has been speaking to the relevant parties," a spokesman for the regulator said. He said he couldn't comment further.

The fresh allegations of market manipulation come as some banks face scrutiny for alleged rigging of benchmark interest rates, including the London interbank offered rate, or Libor.

Fund managers and index providers use the WM/Reuters foreign-exchange rates to value their holdings and assess performance. The rates are based on actual trades or quotes, but, according to the Bloomberg story, can be manipulated by traders concentrating orders in the moments before and during a 60-second window before scheduled rate-setting times.

"In our role as administrator of the WM/Reuters FX rates, we publish spot fixings for the major currency pairs that are derived from actual executed trade data [or, in certain circumstances, order rates] received from multiple execution venues through a streaming rather than solicitation process. The process for capturing this information and calculating the spot fixings is automated and anonymous and the rates are monitored for quality and accuracy," a spokeswoman for State Street said.

A spokesman for Reuters referred questions on the matter to State Street.

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CFO Journal: Credits & Debits

By James Willhite
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-- State Street Corp., a Boston-based financial-services company, said Michael W. Bell will become chief financial officer in August, when current CFO Edward J. Resch retires. Until then, Mr. Bell, most recently CFO of Manulife Financial Corp., will hold the title of executive vice president.

-- QVC, a TV and online retailer owned by Liberty Interactive, hired Ted Jastrzebski as CFO. He succeeds Dan O'Connell, whose retirement plans were announced last summer. Mr. Jastrzebski was most recently president of Hershey Co.'s Americas business.

-- Compuware Corp., a Detroit-based software and professional-services firm, said in a regulatory filing that CFO Laura Fournier has retired and is being succeeded by Joseph Angileri, the company's president and operating chief.

-- Spectrum Pharmaceuticals Inc., based in Henderson, N.Y., hired Kurt A. Gustafson as CFO. He succeeds Brett L. Scott, who was interim CFO and now will be senior vice president of finance.

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Investing in Funds & ETFs: A Monthly Analysis --- Portfolio Strategy: Junk Bonds: Active or Indexed? --- Practitioners of each approach to below-investment-grade debt make their case

By Joe Light
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3 June 2013
The Wall Street Journal
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R7
English

When it comes to investing in "junk" bonds, should fund investors put their money in actively managed funds or passive ones?

That has become a major debate over the past couple of years as billions of dollars flowed into exchange-traded funds that own below-investment-grade bonds. Investors' quest for income has helped push up the prices -- and depress the yields -- of these bonds significantly. In May, the yield of one of the most widely tracked high-yield-bond indexes fell below 5% for the first time ever.

As with other kinds of ETFs, the vast majority of the money has gone to funds that passively track indexes, such as the $11.2 billion SPDR Barclays High Yield Bond ETF (ticker: JNK), run by State Street Global Advisors, a unit of State Street Corp. But some analysts and managers think active management is a better fit for the high-yield market because many issues are thinly traded.

In December 2010, AdvisorShares Investments LLC launched the actively managed Peritus High Yield ETF (HYLD), which now has about $275 million in assets. The active fund trailed JNK in 2011 but delivered a higher return in 2012 and is doing so again so far this year.

How do the two approaches compare -- and have junk bonds gotten too pricey? The Wall Street Journal caught up with Timothy Gramatovich, chief investment officer of Peritus Asset Management LLC, and Brian Kinney, global head of fixed-income beta solutions at State Street. Here are edited excerpts:

WSJ: In other asset classes, passively managed index funds have regularly trounced actively managed funds. What makes high yield any different?

Mr. Gramatovich: Indexing is next to impossible to do in high yield. It's an over-the-counter market. So trading and execution are a large part of your returns. In high yield, liquidity comes and goes, which makes indexing the market very difficult and expensive.

Mr. Kinney: The key benefit to managing a passive strategy in high yield is the same as in other passive funds -- costs. We can manage a portfolio of bonds and get investors exposure to high yield with less trading.

I disagree that there are any specific attributes that make it more difficult per se. We chose a more narrow index that's more investible and liquid, which gives us less transaction costs.

WSJ: If passive managers keep costs lower, won't active managers underperform?

Mr. Gramatovich: You have to remember the main risk you're dealing with in high yield. It's default risk. You're looking to lend money to businesses that create free cash flow, whether it's a $200 million bond issuance or $500 or $600 million. Since we're actively managed, we don't restrict ourselves by issuance size, which passive products must do. We're able to stick to companies that are unlikely to default [including buying attractive smaller issues].

WSJ: There's been some speculation that active managers can "front run" passive ETFs by observing changes in junk-bond indexes and beating passive ETFs to the punch. Is that happening?

Mr. Kinney: There is speculation around what we do and don't need to do. But there's no compelling quantitative evidence that managers are trading to try to anticipate passive funds.

Mr. Gramatovich: I'm with Brian on this one. It's an elegant theory that you hear from time to time, but candidly, [the trading the index funds must do to follow a benchmark] is just a nuance in the market [and not a big opportunity to add value as an active investor].

WSJ: ETFs are known for their ability to create and redeem shares in order to keep share prices in line with the prices of their holdings. In 2009, the share price of the JNK ETF rose 39%, but the value of its underlying assets rose nearly 51%. Is that dislocation a weakness in passive junk ETFs?

Mr. Kinney: [Because the ETF is so easily bought and sold,] the pricing of the ETF is oftentimes a better indicator of true bond prices. Sometimes you'll see bond prices at a premium to the ETF, but the prices will catch up a day or two later. What's happening is that the [ETF] market is getting it right first, and the bond market is catching up.

WSJ: Has Peritus seen the same phenomenon?

Mr. Gramatovich: There was a little bit of deviation in the summer of 2011 but nothing major [in the active fund's shorter existence].

What Brian says makes sense. We've only really had three nuclear winters in this asset class. You wouldn't expect to see the pricing issue again until the next one.

WSJ: Unlike regular mutual funds, active ETFs have to disclose their holdings daily, which some active managers say creates the risk that other traders could see what they're doing and take advantage. Is that a concern?

Mr. Gramatovich: Obviously, if we had our druthers, we wouldn't like to [disclose holdings]. But it hasn't been much of an issue. At the end of the day, you've got to perform.

WSJ: State Street runs an actively managed high-yield-bond mutual fund. Why haven't you tried an active ETF?

Mr. Kinney: Regulators make it a challenge. The time to market is much longer with an active ETF versus a passive ETF. So some of our decisions are around how much time and energy we want to put into filing for an active ETF. Would it be unusual for us to come to market with an active product? No.

WSJ: High-yield prices have been hitting records over the past year. Is there a chance bonds start coming back to earth this year?

Mr. Gramatovich: Non-investment-grade credit represents north of 40% of corporate credit. We look at this and don't understand why people keep [only] a 5% or 10% allocation to high yield. As people start to understand that, we think they'll continue to allocate assets to high yield. A lot has been made about interest rates and the bull market in bonds [coming to an end], but I would say the 10-year Treasury has as much chance of hitting 1% as 3% in the next year.

Mr. Kinney: A lot of time is spent by pundits thinking about high yield on a nominal basis. When you look at it that way, it seems very rich, but no one seems to want to look at it from a spread perspective. Because other sectors have extremely low yields, high-yield bonds in comparison don't look too expensive.

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Utility Stocks Lose Power as the Mood Brightens

By Chris Dieterich
445 words
31 May 2013
The Wall Street Journal
J
C4
English

The lights are going out for utility stocks.

Utilities helped drive the market's rally for much of this year, but have been sinking fast even as the broader market hovers around all-time highs.

The Utilities Select Sector SPDR ETF, the largest exchange-traded fund tied to stocks in the sector, is on pace for its biggest monthly drop since February 2009, down 8.5% so far in May. Seven of the other eight widely traded sector ETFs sponsored by State Street Global Advisors have climbed higher this month.

The Utilities ETF bounced back Thursday, up 10 cents, or 0.3%, to $37.91, after closing Wednesday at its lowest level since March.

Generally slow-but-steady, utility stocks once held strong appeal because of their high dividend payouts and sturdy performance. But rising optimism about the pace of economic growth is prompting ETF investors to move into sectors more closely tied to growth, like technology and industrials.

Others are bailing on utilities because bond yields are rising on speculation that the Federal Reserve might pare back its monthly asset-purchase program. The promise for high payouts from bonds reduces the need to squeeze income from utility stocks, investors say.

In May, money has flowed out of so-called defensive-sector stock ETFs at a fast pace. ETFs that track utility stocks have posted outflows of $267 million, the most since August, according to data through Tuesday from BlackRock Inc. Other defensive sectors such as consumer staples and health-care ETFs also are on track to suffer their biggest monthly outflows of the year.

Picking up the slack are the technology, industrial and consumer-discretionary sectors.

"We had this rush of yield-seekers over the past year, and that translated into flows into utilities, telecommunications stocks and consumer staples," said David Lutz, head of ETF trading strategy at Stifel Nicolaus. "Now we're seeing a rotation away from the sectors where these yield-seekers had favored."

Rising interest rates are helping fuel the exodus. Last week, Fed Chairman Ben Bernanke said the central bank could take a first step toward trimming its bond-buying program. The 10-year Treasury note yield is up nearly half a percentage point from where it started the month.

"There is a correlation between interest rates and utilities since they are fixed-income surrogates," said Scott Davis, portfolio manager for Columbia Management's $8.6 billion dividend income fund. "Historically, people buy them for the yield, so we'd expect to see cost adjustments as bonds become more competitive again."

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THE WALL STREET JOURNAL.

DJ FX Trader
Forex
The Week's Forex Industry News at a Glance

By Alexandra Fletcher
638 words
25 April 2013
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The Wall Street Journal Online
WSJO
English

Here's our weekly rundown of the latest people moves and product launches:

PEOPLE:

-Citigroup Inc. (C) has appointed a new head of electronic foreign exchange trading in London to replace Simon Jones, who left abruptly this month. A person familiar with the situation said Richard Bibbey, the bank's head of trading in currencies and short-term interest rates for Asia in Sydney, Australia, will take on the role. Mr. Bibbey will relocate to London and his replacement will be announced soon.

-CLS, an industry utility for foreign exchange settlement, has announced that five directors have been elected to its board, bringing the total number of directors to 24.

They include: Gerard Gil, a former senior adviser at BNP Paribas SA (BNP.FR); David Hudson, global chief operating officer for rates, FX and public finance at JPMorgan Chase & Co. (JPM); Karen Keenan, head of global markets for Europe, Middle East and Africa at State Street Corp. (STT); Maggie Parent, chief operating officer for operations, technology and data for Morgan Stanley (MS) and Kam Keung Tse, former head of investment servicing for Asia Pacific at State Street Corp.

-Lloyds Banking Group PLC (LYG) said it has appointed Alex Pereira as head of global corporates for FX solutions. He starts on Monday and will report to Jeremy Adam, head of FX market solutions. Mr. Pereira joins from Barclays PLC (BCS).

INDUSTRY:

-Barclays and Credit Suisse Group AG (CS) both reported improved first quarter revenues across their fixed income, commodities and currencies businesses compared to the fourth quarter. The results are similar to those reported by major U.S. banks last week.

Barclays, the third biggest FX bank by market share, saw FICC revenues rise 47% on the quarter to just over 2 billion pounds (about $3 billion) "reflecting seasonally higher contributions from most business areas due to increased volumes and a rally in credit markets."

Credit Suisse, the eighth biggest foreign exchange bank by market share, saw FICC rise by 124% on the quarter to about 2 billion Swiss francs (about $2 billion), reflecting a "seasonal increase in client activity" across fixed income and FX.

-The Chinese yuan regained its position as the 13th most-used currency for international payments in March, after the value of yuan payments surged 32.7% on the month, the Society for Worldwide Interbank Financial Telecommunication said. SWIFT also said the yuan's share of international payments is now at a record 0.74% and that France now leads euro-zone countries exchanging yuan payments.

NEW PRODUCTS/SERVICES:

-Brokerage Tradition has launched its currencies-dealing system ParFX after more than two years of planning and development. The system is backed by 11 banks, including Deutsche Bank AG (DB), Barclays and UBS AG (UBS). Impetus for the new system came after some banks voiced their dissatisfaction with ICAP PLC-owned

(IAP.LN) system EBS, one of the biggest interdealer platforms. EBS has since made changes to allay those concerns.

-Currency brokerage Gain Capital Holdings LLC has rejected a takeover from larger rival FXCM Inc. (FXCM) and instead announced a deal to acquire Global Futures & Forex Ltd, another competing brokerage. Gain officials said in a statement that FXCM's offer would "significantly undervalue" Gain, whereas acquiring GFT for an agreed $107.8 million offered a "substantial opportunity to expand the company's institutional business."

-Global exchange, IntercontinentalExchange Inc. (ICE), is delaying plans to clear foreign exchange swaps until regulatory requirements become more transparent, said a spokeswoman for the firm. The firm originally announced its intention to clear FX swaps a year ago.

--Clare Connaghan and Katie Martin in London and Jacob Bunge in Chicago contributed to this article

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J.P. Morgan Will Lobby for Dimon

By Dan Fitzpatrick, Kirsten Grind and Joann S. Lublin
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6 April 2013
The Wall Street Journal
J
B1
English

Executives and directors of J.P. Morgan Chase & Co. are rallying large investors against a nonbinding shareholder proposal to strip Chief Executive James Dimon of his chairmanship, the latest attempt to restore calm following a multibillion-dollar trading loss.

The largest U.S. bank is arranging conversations with big fund managers in the coming weeks as part of the type of investor-outreach campaign that is increasingly common on Wall Street ahead of annual shareholder gatherings.

J.P. Morgan is scheduling calls and offering meetings with directors for some of its biggest shareholders, including BlackRock Inc. and State Street Global Advisors, a unit of State Street Corp. Other large holders include Vanguard Group Inc., Fidelity Investments and T. Rowe Price Group Inc. Votes on the proposal will be counted at the company's annual meeting next month in Tampa, Fla.

Mr. Dimon has held the chairman and chief executive posts since 2006.

Proponents of separating the two roles also plan extensive shareholder lobbying during coming weeks, including a meeting in Washington with funds that hold large blocks of the company.

J.P. Morgan's effort is a sign that the company is concerned Mr. Dimon may have to relinquish his hold over the board following a series of bad bets that cost the company more than $6 billion and damaged its standing as Wall Street's best risk manager.

The 57-year-old Mr. Dimon is open to the move if the board decides it is appropriate, said people close to him. But the board said in a recent federal filing that it "strongly endorses" the dual roles, a signal it would oppose calls to change the leadership structure.

J.P. Morgan has reached out to top shareholders in previous years on shareholder proposals and typically involves board members in the outreach. The approach highlights banks' efforts to influence key shareholders on contentious issues.

Large investors say they have heard far more from senior management at financial institutions on issues ranging from executive compensation to board structure in the past year than they ever have in the past. It also is increasingly common for independent directors to woo proxy advisers on shareholder resolutions and director elections.

"As we approach our annual meeting, we are conducting our normal shareholder outreach program, which offers an opportunity to review company matters with investors and which sometimes includes conversations with directors," a J.P. Morgan spokesman said.

Large financial firms are under scrutiny for their governance arrangements following their rescue by taxpayers during the financial crisis and a long period of poor stock performance. But most of the big U.S. banks continued to vest both duties in one person. Goldman Sachs Group Inc. also is fighting an effort by activist investors to strip CEO Lloyd Blankfein of his chairmanship.

The activist shareholders calling for Mr. Dimon to be stripped of his chairmanship are led by a big public-employees union, the American Federation of State, County and Municipal Employees. A similar proposal received 40% approval from shareholders in 2012, the highest percentage on such an advisory proposal since at least 2005. It would pass with a majority of votes but the board wouldn't be legally obligated to act.

Proponents are predicting the measure will get higher support in the wake of the losses by a group led by a trader known as the "London whale" for his large positions.

Passage "is a possibility," said Brandon Rees, acting head of AFL-CIO's Office of Investment. "I can't think of another company where independent board leadership would be a more useful correction for CEO hubris."

The closest J.P. Morgan has to an independent chair is a "presiding" director who is elected annually and oversees executive sessions of independent directors and all board meetings in which the chairman isn't present. The current presiding director is Lee Raymond, the former head of Exxon Mobil Corp.

When the board announced a 50% cut in Mr. Dimon's compensation, to $11.5 million from $23.1 million the year before, it said he bears "ultimate responsibility" for the failures. But in a filing last month the board said "once Mr. Dimon became aware of the seriousness of the issues" he "responded forcefully."

The board has largely escaped blame for the 2012 trading losses in the firm's Chief Investment Office. It formed a three-person committee to investigate the episode, and concluded that directors weren't culpable because they saw no red flags about the trades. The board also decided "it was not in the best interests of the company" to initiate any litigation against current or former employees or directors, Mr. Raymond said in a letter reviewed by The Wall Street Journal.

But board members in recent weeks have discussed whether they need to do more in the wake of a report by the U.S. Senate's Permanent Subcommittee on Investigations that concluded the bank brushed off internal warnings and misled regulators and investors about the scope of the losses. No final decision has been made, said a person briefed on the discussions, but directors could explore questions raised by the report not previously reviewed by the board or management. "We have all discussed at all levels of the company what we could learn from this report," the bank spokesman said.

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THE WALL STREET JOURNAL.

Markets

State Street, Blackstone Join to Offer New Loan ETF

By Katy Burne
551 words
4 April 2013
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WSJO
English

Two established Wall Street players are teaming up to launch a rare exchange-traded fund for high-yield loans as demand for such investments rises in anticipation of rising interest rates in coming years.

The fund launched Thursday is the first to be offered jointly by ETF provider State Street Global Advisors and Blackstone Group's credit unit GSO Capital Partners. It is also the first actively managed ETF with exposure to senior loans. Being actively managed means it aims to beat the performance of the overall loan market. Passive ETFs often seek simply to match the market's performance. The fund will trade under the ticker symbol "SRLN" on the New York Stock Exchange's Arca platform.

Investors have poured into the market for high yield, or leveraged, loans since the beginning of 2012 amid expectations that central banks in the next few years will start to ratchet up benchmark interest rates.

Rising rates hurt the prices of fixed-rate debt, such as lower-yielding investment-grade corporate bonds. But loans have floating interest rates so investors are protected and make more if rates go up.

State Street had been in talks with Blackstone for three years, and was attracted to the firm's "significant scale and familiarity" with debt investments, said James Ross, senior managing director at State Street Global Advisors, the second-largest global ETF provider behind BlackRock Inc.

Many investors now prefer leveraged loans to high-yield bonds because investors in a company's loans are paid first, ahead of bondholders, when a company runs into trouble. Loans are also secured by a borrower's assets, unlike many bonds. Some investors have shifted into loans, worried that they are not getting enough protection against defaults when they buy bonds of a risky issuer.

"Senior secured loans offer investors both attractive risk-adjusted returns today and help protect against interest-rate increases," said Lee Shaiman, a managing director at Blackstone's GSO unit.

The two existing high-yield loan ETFs are "on fire," said Jeffrey Tjornehoj, senior research analyst at Thomson Reuters unit Lipper.

One run by Invesco unit PowerShares, trading under the ticker symbol BKLN, is now $2.9 billion in size; $1.45 billion of that growth came in 2013.

The other is the iBoxx senior loan ETF run by Highland Capital Management, trading under SNLN, which started in November and has $60 million.

Loan ETFs have taken in more than $100 million routinely each week, according to Lipper data, with only five weeks of outflows in 2012 and none of significant proportions.

The investment objective of the State Street/Blackstone GSO senior loan ETF is to outperform two loan indexes: the Markit iBoxx USD Liquid Leverage Loan Index and the S&P/LSTA U.S. Leveraged Loan 100 Index.

Blackstone isn't State Street's only partner in its ETF business. It recently announced it would be joining forces with MFS Investment Management on stock ETFs. In 1993, State Street was the original developer of the $130 billion ETF tracking the Standard & Poor's 500 stock index, trading under the ticker SPY, with what was then the American Stock Exchange.

Write to Katy Burne at katy.burne@dowjones.com

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THE WALL STREET JOURNAL.
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Investing in Funds & ETFs: A Monthly Analysis --- Exchange-Traded Funds: Firms Try Varied Designs to Add ETFs --- Vanguard Group patent forces other fund companies to think creatively with new offerings

By Ari I. Weinberg
1,132 words
4 February 2013
The Wall Street Journal
J
R4
English

Established mutual-fund companies seeking to add exchange-traded funds to their lineups have a challenge: They need to find a cost-effective way to launch the products in a market where Vanguard Group has one potential design locked up.

More than a decade ago, Vanguard pioneered the idea of offering ETFs as a separate share class of existing mutual funds to create economies of scale and keep costs low. The Malvern, Pa., firm later secured a patent on the structure and so far has kept a monopoly on it.

Of course, there are other options for firms wanting to launch ETF versions of existing mutual funds or new funds with both ETF and mutual-fund availability. One approach involves structuring the ETF as a stand-alone fund that resembles a traditional fund. This is the route Pacific Investment Management Co., a unit of Allianz SE, took last year when it launched the ETF version of its flagship Pimco Total Return bond fund.

A newer idea, used by State Street Corp.'s State Street Global Advisors, is to connect the ETF to an existing mutual fund in a so-called master-feeder design. The ETF channels investor dollars into the existing fund and holds only shares in that fund. "Master-feeder is the beginning of new innovation on improving the ETF structure," says Richard Keary of Global ETF Advisors LLC.

Here is a closer look at the three approaches:

Vanguard's Share Class

Vanguard's first ETF debuted in May 2001, a few months after the company applied for a patent on its design. The patent was granted four years later, and in the ensuing years, the mutual-fund giant became the third-largest issuer of ETFs in the U.S., behind BlackRock Inc. and State Street.

The patent states that the share-class design eliminates the "significant disadvantages" that arise when ETFs are launched as separate funds. The share-class structure also benefits investors in that they can transfer from fund shares into ETF shares without any tax penalties. The structure allows "everyone in every share class to have the same experience, gross of expenses," says Joel Dickson, a senior investment strategist at Vanguard.

Still, industry observers are mixed on the value of the patent, which a Vanguard spokesman says expires in 2023. Some say it may be valuable only for traditional index funds; they note that Vanguard hasn't used the design to launch ETF versions of any of its actively managed mutual funds. (Creating an ETF version of an actively managed fund can be tricky because many managers are reluctant to disclose their holdings on a daily basis.) Others say the patent may not be worth the cost of challenging it or licensing it.

Last year, New York-based Van Eck Global proposed the possibility of launching ETF share classes of some of its existing funds in a filing with the U.S. Securities and Exchange Commission. It isn't clear if Van Eck's proposal would use Vanguard's patent through a licensing agreement or if Van Eck would actually challenge it. Both firms have declined to comment.

ETFs as Separate Funds

Before Vanguard entered the scene, ETFs were launched as stand-alone funds, and most of them tracked indexes. Index-tracking ETFs are relatively cheap to run, but they still need a certain level of assets to operate efficiently.

While Vanguard ramped up business by piggybacking on established funds, some asset managers have launched ETFs from scratch in recent years -- and had no problem attracting investors to them.

Case in point is Pimco. After three years of moderate ETF success, the firm introduced the actively managed Pimco Total Return ETF as a stand-alone fund in March 2012. The ETF closely follows the strategies of its mutual-fund counterpart, and both funds are run by bond guru Bill Gross. Helped by its manager's reputation, the ETF attracted more than $4 billion in assets in less than a year, allowing it to easily avoid problems that can plague small funds.

At the time of the launch, there was a restriction on derivative use by new companies offering active ETFs. Considering the traditional Total Return fund uses derivatives, that may have played a role in Pimco's decision to create a separate ETF.

Pimco didn't respond to a request for comment.

The founders of ProFunds also chose the separate-fund design when they launched the ProShares ETFs in 2006. The ETFs and their related mutual funds offer daily inverse and leveraged exposure to indexes and sectors. The fact that the ETFs can be traded during the day made them a hot commodity, particularly during the up-and-down days of the financial crisis. At the end of 2012, the ETFs had $21.2 billion in assets, while the traditional funds had $5 billion.

Master-Feeder

The master-feeder structure isn't uncommon throughout the fund world, but has only recently been applied to ETFs, says Rajib Chanda, a lawyer with Ropes & Gray LLP in Washington who focuses on investment management and securities law.

In this structure, each feeder fund bears its own administrative costs and pays its pro-rata share of the portfolio management. Mr. Keary of Global ETF Advisors says this structure creates operational efficiencies that help keep expense ratios low. Unlike the Vanguard structure, however, there is no option for investors to convert their shares from one feeder fund to another.

State Street Global Advisors recently used this method to launch a suite of three actively managed ETFs of ETFs, including the $86 million SPDR SSgA Income Allocation ETF. The ETFs hold only shares of their respective master funds. So far, the ETFs are the only feeder funds and the master funds have no other shareholders.

Scott Ebner, head of global ETF product development at SSgA, says the structure provides flexibility for the funds in the future. The master fund, for example, could potentially be made available to investors who don't want or need an ETF but like the investment strategy.

Fidelity Investments is in the final stages of getting SEC approval to launch index ETFs via the master-feeder design. A spokesman declined to discuss the firm's plans.

Firms such as T. Rowe Price Group and Northern Trust Investments already have the go-ahead for ETF feeder funds, should they chose to offer them.

Mr. Weinberg is a writer in New York. Email him at reports@wsj.com.

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THE WALL STREET JOURNAL.

Markets

Exchange-Traded Funds; Firms Try Varied Designs to Add ETFs; Vanguard Group patent forces other fund companies to think creatively with new offerings

By Ari I. Weinberg
1,108 words
3 February 2013
03:47 PM
The Wall Street Journal Online
WSJO
English

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Of course, there are other options for firms wanting to launch ETF versions of existing mutual funds or new funds with both ETF and mutual-fund availability. One approach involves structuring the ETF as a stand-alone fund that resembles a traditional fund. This is the route Pacific Investment Management Co., a unit of Allianz SE, took last year when it launched the ETF version of its flagship Pimco Total Return bond fund.

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Mr. Weinberg is a writer in New York. Email him at reports@wsj.com.

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State Street Stake Pared By Activist Investor

By Sharon Terlep
851 words
29 January 2013
The Wall Street Journal
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English

Nelson Peltz is backing away from State Street Corp.

The activist investor's Trian Fund Management LP has sold part of the stake it disclosed when he pounced on the trust bank in October 2011, demanding a turnaround, according to people familiar with the decision.

While Trian pocketed a profit on the sale, the move came at a per-share price far below what Mr. Peltz and the firm's two other founding partners stated State Street would be worth if it followed their "action plan."

It isn't clear how many State Street shares still are held by Trian or how much it walked away with after reducing the stake near the end of last year. State Street shares closed Monday at $56.39 in New York Stock Exchange composite trading. The size of Trian's stake is likely to be disclosed next month as part of the New York investment firm's overall holdings.

The stock has been buoyed by planned cost cuts that include nearly 3,000 job cuts, increased dividends and share buybacks by the Boston company. Shares jumped earlier this month when the company said it would cut more jobs and look to increase the buyback.

State Street traded near $34 when Trian announced its stake and threatened to "become significantly more active" if executives and directors didn't respond aggressively.

Mr. Peltz and Trian co-founders Ed Garden and Peter May are known for their headline-grabbing assaults on firms they see as laggards. They say they try to work with companies collaboratively. Other investors often follow well-known activists in and out of their investments.

At State Street, Trian's demands included "considering" a spinoff of investment-management and servicing units. The activist firm no longer plans to push for a split even though it will keep a "meaningful" stake in State Street, said a person familiar with the move, who added that the company felt the money it invested in State Street could be put to better use elsewhere.

A State Street spokeswoman said that the bank has "ongoing discussions with many of our shareholders, and we listen carefully and respectfully to all the feedback that we receive."

Trian never said how long it planned to ride out its investment in State Street or what would cause the investment firm to change direction. The October 2011 letter to State Street's board referred to Trian as "a long-term shareholder that believes in State Street's enormous potential for value creation." The bank could be valued at about $99 in 2014, the firm estimated. When Trian disclosed its 3.3% stake, those shares were valued at about $560 million.

Activist investors often cash out of target companies before accomplishing their public goals. But the reversal by Trian shows the potential downside when individual investors copy moves by high-profile agitators such as Mr. Peltz, David Einhorn, William Ackman and Carl Icahn.

"It is dangerous for any investor to anticipate future price moves based on hedge-fund managers talking their book," said Scott Clemons, a managing director and chief investment strategist at Brown Brothers Harriman Wealth Management in New York. "It's more akin to gambling than investing."

Ken Squire, founder and principal of 13D Monitor, a New York research firm specializing in shareholder activism, said the share prices of companies with a stock-market capitalization of more than $1 billion immediately jump by an average of about 2.6% when targeted by a top activist investor. State Street has a stock-market value of about $26 billion. It was an easy target for Mr. Peltz and his investment partners because of what they said was "a culture that has prioritized growth over profitability and has led to dilutive acquisitions, inadequate cost management and significant non-recurring charges."

When Trian disclosed its stake and blasted State Street in a 40-page action plan, the investment firm said it had pushed the bank behind the scenes for about a year. State Street undertook steps advocated by Trian, including a cost-cutting plan announced by the bank before Trian went public with its own proposals. State Street also bolstered per-share profit through a share-repurchase program.

Trian criticized State Street for failing to return more capital to shareholders. The bank countered that it wanted to be more shareholder friendly but was awaiting approval from the Federal Reserve, a requirement because State Street got taxpayer-backed aid during the financial crisis. State Street launched a buyback program last year after getting clearance from the Fed.

Trian tangled with State Street over the bank's top management, with Messrs. Garden and May appealing directly to board members, people familiar with the discussions said. It was a positive move to Trian when State Street's longtime finance chief, Edward Resch, stepped down last year, one of the people said. State Street said Mr. Resch's retirement was unrelated to investor discontent.

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THE WALL STREET JOURNAL.

Markets
State Street Stake Pared by Activist Investor

By Sharon Terlep
845 words
28 January 2013
09:07 PM
The Wall Street Journal Online
WSJO
English

Nelson Peltz is backing away from State Street Corp.

The activist investor's Trian Fund Management LP has sold part of the stake it disclosed when he pounced on the trust bank in October 2011, demanding a turnaround, according to people familiar with the decision.

While Trian pocketed a profit on the sale, the move came at a per-share price far below what Mr. Peltz and the firm's two other founding partners stated State Street would be worth if it followed their "action plan."

It isn't clear how many State Street shares still are held by Trian or how much it walked away with after reducing the stake near the end of last year. State Street shares closed Monday at $56.39 in New York Stock Exchange composite trading. The size of Trian's stake is likely to be disclosed next month as part of the New York investment firm's overall holdings.

The stock has been buoyed by planned cost cuts that include nearly 3,000 job cuts, increased dividends and share buybacks by the Boston company. Shares jumped earlier this month when the company said it would cut more jobs and look to increase the buyback.

State Street traded near $34 when Trian announced its stake and threatened to "become significantly more active" if executives and directors didn't respond aggressively.

Mr. Peltz and Trian co-founders Ed Garden and Peter May are known for their headline-grabbing assaults on firms they see as laggards. They say they try to work with companies collaboratively. Other investors often follow well-known activists in and out of their investments.

At State Street, Trian's demands included "considering" a spinoff of investment-management and servicing units. The activist firm no longer plans to push for a split even though it will keep a "meaningful" stake in State Street, said a person familiar with the move, who added that the company felt the money it invested in State Street could be put to better use elsewhere.

A State Street spokeswoman said that the bank has "ongoing discussions with many of our shareholders, and we listen carefully and respectfully to all the feedback that we receive."

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THE WALL STREET JOURNAL.

Markets
State Street Profit Climbs 23%

By Liz Moyer And Melodie Warner
544 words
18 January 2013
10:38 AM
The Wall Street Journal Online
WSJO
English

State Street Corp.'s fourth-quarter earnings beat expectations, rising 23% as higher servicing fees helped to offset lower trading-services and securities finance revenue.

Revenue of $2.4 billion rose 6%, while expenses of $1.8 billion rose 4%, providing the positive operating leverage investors have been pushing State Street to achieve.

Shares recently rose 6.7% to $53.79, hitting their highest point in more than three years. The stock has gained 35% over the past 12 months.

State Street is one of the country's largest trust banks, acting as a custodian for investment firms' securities and handling other back-office duties. As with many financial firms, the company's top and bottom lines have been pressured by historically low interest rates and declining trading volumes.

On a conference call to discuss earnings on Friday, Chairman and Chief Executive Joseph Hooley said late-year trends in client activity boded well for the start of the new year. In December, clients that had waited out last year's economic uncertainty started moving assets out of conservative fixed-income investments and into riskier U.S. and global equities. That re-risking has continued into January, he said.

"I remain confident in the secular trends underpinning the prospects for growth in this business and I believe we have the right focus in the short term to position us well for continued strong performance," Mr. Hooley said.

State Street continues to take a hard line on expenses despite improving business trends. It disclosed plans to cut about 630 positions world-wide and take a $139 million restructuring charge, actions it said would better align its expenses with its business outlook for 2013. The company had 29,740 employees at the end of 2011.

State Street has already taken some cost-control measures, such as withdrawing from its fixed-income-trading initiative and making targeted staff reductions. It is undergoing a multiyear effort to streamline technology and reduce costs, anticipating $220 million of cost savings this year as part of that program.

The company also bought Goldman Sachs Group Inc.'s hedge-fund administration business for $550 million in October, a deal that makes State Street the biggest manager of behind-the-scenes activities for hedge funds, such as tax reporting and accounting.

State Street reported a profit of $470 million, or $1 a share, up from $381 million, or 76 cents a share, a year earlier. Excluding items such as litigation, acquisition and restructuring costs, adjusted earnings rose to $1.11 a share from 93 cents.

Analysts polled by Thomson Reuters had most recently forecast earnings of $1 a share on revenue of $2.36 billion.

Servicing fees rose 8.8% to $1.15 billion.

Trading-services revenue, which includes foreign-exchange trading revenue and brokerage and other fees, declined 11% to $243 million. Securities finance revenue dropped 18% to $74 million.

Total assets under management as of Dec. 31 were $2.089 trillion, up 13% from $1.845 trillion a year ago. Assets under custody and administration rose 12%, to $24.4 trillion.

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Investing in Funds: A Monthly Analysis --- What's in a Name? When It Comes to ETFs, Sometimes Not a Whole Lot

By Karen Damato
722 words
3 December 2012
The Wall Street Journal
J
R1
English

Most ETF names appear to leave little to the imagination. They seem to describe what the fund is all about.

But beware: Sometimes you can't judge an ETF by its cover.

A "Middle East & Africa" fund with only 5% of assets in the Middle East? A "BRIC" fund -- you know, for Brazil, Russia, India and China -- that has just 2% of its assets in Russia? A "homebuilders" fund that has only 26% of its assets in companies that build homes?

Yes, that's right.

In many cases, the ETFs are simply aping the names of the indexes they track, so the issue is more one of index composition than duplicitous marketing. But "a misleading name is a misleading name," says Robert Goldsborough, an ETF analyst with investment researcher Morningstar Inc. And "the first thing anyone sees about an ETF is the name."

ETF sponsor State Street Global Advisors, a unit of State Street Corp., recently noted in an online checklist designed to help investors analyze ETFs that "many ETFs belie their name." Thus, "it's necessary to look beyond the fund's name or the index it tracks" to analyze the underlying holdings.

Some questionable names are found in State Street's own lineup, researchers say. IndexUniverse points to

SPDR S&P Emerging Middle East & Africa, an $88 million ETF that recently had 91% of its assets in South Africa, 4% in Morocco and -- for its Middle East exposure -- 5% in Egypt. Egypt is the only Middle East country that Standard & Poor's classifies as an "emerging" economy.

Mr. Goldsborough takes issue with State Street's $2.2 billion SPDR S&P Homebuilders. It recently had 74% of assets in companies that are related to but not directly engaged in home building, such as top holdings Whirlpool Corp. and Lowe's Cos.

A State Street spokeswoman didn't respond to requests for comment.

In a report earlier this year, Casey Research LLC, which provides investment research to subscribers, highlighted an issue that affects many commodities ETFs. Rather than tracking spot prices, they are linked to the prices of futures contracts, and performance can diverge from the spot price as funds roll their holdings from one contract to another. As such, the $1.4 billion

U.S. Oil "isn't a bet on the oil price" as most individuals hear oil prices quoted, Casey senior analyst Vedran Vuk says. In 2009, the fund returned 19%, while the spot price doubled.

U.S. Oil's focus on futures is clearly disclosed and "we didn't call it the United States Spot Oil Fund," says John Hyland, chief investment officer at U.S. Commodity Funds LLC.

The biggest number of potentially confusing names may lie among ETFs that pick holdings based on geography and country characteristics.

Both Morningstar and IndexUniverse note that the $148 million Guggenheim Frontier Markets has the majority of its assets in four countries -- Chile, Colombia, Egypt and Peru -- that generally are found in "emerging," not "frontier," funds. (In general, a frontier market is at an earlier stage of development than an emerging market.) The analysts say the Guggenheim ETF uses classifications from Bank of New York Mellon Corp., which are very different from those used by other index providers. Guggenheim Investments declined to comment.

Then there's a pair of funds whose weightings in Russia are very different -- and both potentially unexpected. Casey Research says BlackRock Inc.'s iShares MSCI Emerging Markets Eastern Europe Index

has 73% of its assets in Russia. A BlackRock spokeswoman says the big Russia stake is consistent with the ETF's benchmark.

Meanwhile, both Morningstar and IndexUniverse have called out the $323 million Guggenheim BRIC for its recent 2% exposure to Russia. The issue is the fund tracks an index that excludes shares traded only in the named countries, and few Russian stocks are listed overseas. "It is really a BIC ETF," Mr. Goldsborough says.

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CFO Journal: Credits & Debits

By Maxwell Murphy
598 words
27 November 2012
The Wall Street Journal
J
B6
English

-- Videogame developer THQ Inc., based in Agoura Hills, Calif., said Chief Financial Officer Paul Pucino resigned. The company said it is "evaluating its alternatives" with respect to the CFO job, and has retained FTI Consulting to assist its finance and accounting team. Mr. Pucino received compensation valued at $688,568 for the company's fiscal year ended March 31, according to its proxy.

-- Diamond Foods Inc., based in Stockton, Calif., said in a regulatory filing Wednesday that it fired Steven M. Neil, its former CFO, on Nov. 19. Mr. Neil, along with Diamond's former president and chief executive, Michael J. Mendes, had been placed on administrative leave in February amid an accounting scandal involving the timing of payments to walnut growers. Mr. Neil isn't eligible for, and won't be paid, any severance or other separation payment in connection with his termination, Diamond said.

-- State Street Corp. said CFO Edward J. Resch plans to retire in 2013, after more than a decade in that role at the Boston-based financial-services company. The timing of his retirement "will enable a thorough transition process to his successor," CEO Jay Hooley said in a news release. Mr. Resch received compensation valued at $8.1 million in 2011, according to a proxy filing.

-- Aegon NV, a Netherlands-based insurer and pension company, named Darryl Button, 43, as CFO. He will succeed Jan Nooitgedagt, 59, who is retiring. The appointment is subject to the approval of the Dutch Central Bank. Mr. Button, a Canadian, joined Aegon in 1999 and has been the head of its corporate financial center since the beginning of September.

-- Kirkland's Inc., a retailer based in Nashville, said CFO Mike Madden will become acting president and chief executive while its CEO, Robert Alderson, takes a medical leave of absence. The absence, to recover from an undisclosed "non-emergency medical procedure," was effective Nov. 26 and expected to last about six to eight weeks. The specialty home-decor chain said it "fully expects" Mr. Alderson to resume his duties after the medical leave.

-- PMC-Sierra Inc., a semiconductor firm based in Sunnyvale, Calif., named Steven Geiser as CFO to replace Mike Zellner, who it said would stay on until the end of the year to assist with the transition. Mr. Geiser was most recently the CFO of two early-stage companies, and previously worked for Advanced Micro Devices Inc., where he rose to become CFO of a joint venture between AMD and Fujitsu that eventually went public.

-- Emergent BioSolutions Inc., based in Rockville, Md., named Robert Kramer, a company veteran who was previously CFO and was most recently in charge of its corporate-services division, to the added post of CFO. He replaces Don Elsey, who the company said was leaving to pursue an opportunity at a private health-care company. Mr. Kramer joined Emergent as CFO in 1999, and worked in various positions through his retirement in 2010. He was a consultant for the company last year and earlier this year rejoined as head of corporate services.

-- Zeltiq Aesthetics Inc., a medical-technology company based in Pleasanton, Calif., tapped Patrick Williams as CFO. The company said Mr. Williams most recently spent more than five years in strategy, finance and investor relations roles with NuVasive. Zeltiq CEO Mark Foley had held the CFO post on an interim basis since the company's former CFO resigned in early August.

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THE WALL STREET JOURNAL.

DJ FX Trader
Forex
Ireland's Debt Agency Chief Alleges State Street Bank of Fraud

By Eamon Quinn
519 words
22 November 2012
10:23 AM
The Wall Street Journal Online
WSJO
English

The head of Ireland's national debt office Thursday said he considered State Street Bank Europe had been involved in a "fraudulent act" in "siphoning off" unauthorized 3.2 million euros ($4.1 million) of fees from the country's sovereign pension fund last year.

John Corrigan, chief executive of the National Treasury Management Agency, told a parliamentary committee that State Street had repaid the EUR3.2 million to the country's National Pension Reserve Fund, but "unfinished business" remains to be dealt with.

Mr. Corrigan said the NTMA had informed the Irish police, but that the agency is waiting for U.K. regulator, the Financial Services Authority, to complete an investigation before deciding on further action, he said.

It was an "eye-opener" to him that an institution of such high repute like State Street would be involved in such matters, Mr. Corrigan said. He said he had met with a senior State Street executive in Dublin, but State Street hadn't "described" the matter as fraudulent behavior.

Lawmakers from the public accounts committee were questioning Mr. Corrigan about a report the Irish parliament's auditor published earlier this year into the State Street fees.

That report by the Comptroller & Auditor General said State Street Bank Europe was hired by Ireland's National Pension Reserve Fund to liquidate EUR4.7 billion of the fund's assets in 2011 for a management fee of EUR698,000.

The proceeds from the sale was part of the Irish government's program to recapitalize stricken Irish lenders during the country's deep debt crisis.

According to the report, State Street Bank Europe in London applied "unauthorized" commissions of EUR2.6 million "for which there was no contractual agreement," and also earned EUR0.6 million in profit from the sale of the pension fund's investment in an index fund "while acting as a principal but without taking any risk of loss."

State Street had refunded the pension fund the unauthorized commissions and the trading profits, the report found.

A spokesman for State Street said it had "self-reported" the matter to the FSA in September 2011. "In a limited number of instances, we charged commissions on transition management mandates that were not consistent with our contractual agreements," the spokesman said in a statement.

"Our transition management business is predicated on fair and comprehensive disclosure to our clients. As a result of our own internal analysis, we have determined that certain employees failed to comply with the high standards of conduct, communication and transparency that we expect. Those individuals are no longer with the company," State Street said.

"The actions of these former employees and their interaction with a small number of clients do not reflect the high standards of conduct, communications and transparency that State Street expects. We took swift and appropriate disciplinary actions in response to this conduct," the bank said.

The bank said it had "enhanced" its controls over the business.

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THE WALL STREET JOURNAL.

Business
State Street's Revenue Falls

By Melodie Warner
391 words
16 October 2012
07:44 AM
The Wall Street Journal Online
WSJO
English

State Street Corp.'s third-quarter earnings rose 21%, bolstered by a one-time gain, as revenue declined more than expected.

"Our third-quarter results reflect continued resilience across both asset servicing and asset management, partially offset by weakness in trading services," said Chairman and Chief Executive Officer Joseph L. Hooley. "Although equity markets have improved, clients remain conservative in their investment allocations which adversely affects our revenue."

State Street is one of the country's largest trust banks, acting as a custodian for investment firms' securities and handling other back-office duties. Like many financial firms, the company's top and bottom lines have been pressured by historically low interest rates and declining trading volumes.

State Street has taken cost-control measures, such as withdrawing from a fixed-income-trading initiative and making targeted staff reductions. It also completed its $550 million acquisition of Goldman Sachs Group Inc.'s hedge-fund administration business on Monday, a deal that makes State Street the biggest manager of behind-the-scenes activities for hedge funds, such as tax reporting and accounting.

State Street reported a profit of $674 million, or $1.36 a share, up from $555 million, or $1.10 a share, a year earlier. The most recent quarter included a gain of 35 cents a share, primarily for claims associated with the 2008 Lehman Brothers bankruptcy. Adjusted per-share earnings rose to 99 cents from 96 cents.

Revenue dropped 2.9% to $2.36 billion.

Analysts surveyed by Thomson Reuters had most recently forecast earnings of 96 cents per share, with revenue of $2.37 billion.

Servicing fees were down 0.5% to $1.1 billion.

Trading-services revenue, which includes foreign-exchange trading revenue and brokerage and other fees, declined 31% to $232 million. Foreign-exchange trading revenue decreased 44%, while brokerage and other fees were down 10%.

Securities finance revenue jumped 7.1% to $91 million.

Total assets under management as of at Sept. 30 were $2.065 trillion, up 11% from $1.855 trillion a year earlier.

Shares closed Monday at $41.58 and were inactive in the premarket. The stock has risen 3.2% so far this year.

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THE WALL STREET JOURNAL.

DJ FX Trader
Forex

Swiss Franc Unaffected by State Street Charges

By Eva Szalay
634 words
9 October 2012
09:56 AM
The Wall Street Journal Online
WSJO
English

State Street Corp.'s (STT) decision to levy charges on its Swiss franc deposit accounts briefly pushed the Swiss currency lower Tuesday but is unlikely to have any longer-term impact unless other major players do the same, say analysts.

The euro briefly rose to 1.2143 Swiss francs from around CHF1.2103 in Asian trading before reversing those gains and settling back down to trade just above CHF1.21, when State Street became the first major bank to apply negative rates to Swiss deposits. It will charge 0.25% on Swiss franc deposits and 0.75% on Danish krona accounts.

"State Street has been closely monitoring central bank activity, swap markets and the overnight cash markets, and based on market conditions will start to apply negative interest rates in two currencies, Danish krone and Swiss francs, beginning on Nov. 1, 2012," the company said. It said the charges will only affect a "small percentage" of customers.

State Street Bank says on its website that it has $22.4 trillion in assets under custody and administration. It ranks among the top 20 currency trading banks according to an influential annual survey.

"Initially the market thought that the charges would deter capital inflows into Swiss accounts and were perhaps fearful that other banks might follow suit, but looking at the move in the exchange rate it seems they might have re-evaluated this view," said Peter Von Maydell, head of fixed income and foreign exchange research at Credit Suisse in London.

Investors have been on high alert for any tweaks in the Swiss National Bank's policy since September last year when it installed a minimum exchange rate for the single currency. The move aimed to stanch massive cash inflows that drove the franc higher as investors fled the euro crisis.

The SNB's intervention came after investors pushed the franc to near parity with the euro, causing severe difficulties for Swiss exporters who form the backbone of the Swiss economy. The strong currency also increased deflationary pressure in the country and threatened to derail economic growth.

While the SNB hasn't imposed negative rates on deposits and it kept its target rate unchanged at 0.0% at its last meeting, banks have effectively been paying negative rates on franc deposits for months as inflation in the country ran at 0.3% in September.

"We doubt the [State Street] news will have a lasting weakening effect on the Swiss franc," said Chris Walker, a currency strategist at UBS in London. "It would be a different story if it was the central bank who imposed negative rates but, as it is, I think the 25 basis point fee is really not much and it will not deter investors who want to hold franc deposits for safety."

For now a similar move from the central bank looks unlikely as the euro crisis risks have appeared to decline since late July when the European Central Bank announced it would be prepared to buy sovereign bonds of struggling euro-zone members to keep debt funding costs in those countries at sustainable levels.

As a result, demand for Swiss assets has also declined and the euro is now trading some 0.5% higher against the franc since the start of September, after spending the majority of the year pinned to the CHF1.20 floor.

"Capital inflows to Switzerland have declined significantly since late July and I don't think the SNB needs to do anything more to deter investors at the moment," Mr. Von Maydell said.

At 1347 GMT the euro was trading at CHF1.2109.

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THE WALL STREET JOURNAL.

Markets
Euro Hits Four-Month High as the Dollar Sinks Broadly

By Nicole Hong
476 words
11 September 2012
07:50 PM
The Wall Street Journal Online
WSJO
English

The euro jumped to an 18-week high against the dollar on Tuesday ahead of a key ruling on the constitutionality of the euro-zone's bailout fund.

Germany's Constitutional Court will decide on Wednesday if the European Stability Mechanism, the permanent bailout fund for the 17-country currency bloc, is legal under the German constitution.

On Tuesday, Germany's finance minister said he expects the court to issue a pro-European ruling, stoking investor optimism. The court also confirmed that it wouldn't delay the decision.

The common currency traded up to $1.2872, its highest level against the dollar since May 14. It ended the day at $1.2861 from $1.2760 late Monday.

"The perception is that the German Constitutional Court is not going to do anything that would undermine the current ESM plans, which is a positive for markets," said Robert Blake, senior currency strategist at asset manager State Street Global Advisors in Boston.

The euro has rallied 6% against the dollar since early August on optimism that the European Central Bank can relieve financial stresses in struggling euro-zone countries like Spain and Italy. Last week, the ECB unveiled a new proposal for unlimited bond-buying in peripheral countries if they ask for help.

"People think the ECB is finally getting ahead of the curve, not behind it," said MacNeil Curry, head of foreign-exchange and interest-rates technical strategy at Bank of AmericaMerrill Lynch in New York.

The dollar also fell broadly against major currencies as expectations climbed that the Federal Reserve will launch a third round of quantitative easing, or QE3, this week to stimulate the economy. A key factor driving expectations is the weak August jobs report from last week, which came in well below estimates.

The Fed's policy-setting meeting ends Thursday. Analysts widely expect the Fed to extend its expectation for low interest rates into 2015 from a previous guidance of late 2014. However, there's more uncertainty about the size, timeframe and asset class for new Fed bond purchases.

"It doesn't look good for the dollar," said Win Thin, currency strategist at Brown Brothers Harriman in New York. "The one thing that could throw a monkey wrench in this is if the Fed does not" announce QE3, he added.

Against the yen, the dollar dropped to a 14-week low of ¥77.71, ending the session at ¥77.78 from ¥78.28 late Monday.

The Australian dollar also rose to a two-week high against the dollar. It last traded at $1.0447, up 1.1% from $1.0335.

The Wall Street Journal Dollar Index, which measures the dollar against a basket of currencies, fell to 69.704 from 70.205.

Matthew Walter contributed to this article.

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THE WALL STREET JOURNAL.
U.S. EDITION

Investing in Funds: A Monthly Analysis --- Exchange-Traded Funds: Lots of ETFs, but So Many Are Tiny --- Investing in the smallest funds carries risks not associated with the giants; To wit: Will my ETF shut down?

By Ari I. Weinberg
650 words
5 September 2012
The Wall Street Journal
J
C16
English

The world of exchange-traded funds is notoriously top-heavy, and that has implications for investors in both the largest and smallest ETFs.

Just one fund, SPDR S&P 500, holds 8.5% of the assets in all U.S.-listed ETFs, with $104 billion as of Aug. 15, according to research firm XTF. This mammoth ETF accounts for one-third of the dollar-weighted average daily trading volume of these products. And taken with the 21 other ETFs that have amassed assets of more than $10 billion each, this exclusive group accounted for nearly half of the assets in U.S.-based ETFs as of mid-August.

The size and trading activity of these giant funds make the funds easy to buy and sell, even in large quantities, at prices that tightly track the value of the underlying securities. Also crucial to large ETFs are highly liquid markets for the underlying securities held by the funds.

At the very top of the pile, meanwhile, only three companies control 80% of the U.S. ETF market, according to XTF. BlackRock Inc.'s iShares unit manages 12 of the 22 ETFs with more than $10 billion each. The fastest-growing among the large-fund families, Vanguard Group, holds five spots, including the third-largest fund, Vanguard MSCI Emerging Markets. And State Street Corp. claims Nos. 1 and 2, with two innovative, first-to-market products: the SPDR S&P 500 (introduced in 1993) and SPDR Gold Trust (in 2004).

The only firm outside the Big Three that has a fund with more than $10 billion in assets is Invesco Ltd.'s Invesco PowerShares: Launched in 1999, PowerShares QQQ tracks the Nasdaq-100 index. The fund represents one of the first and most successful ETFs built on a then-emerging investing trend-- technology companies.

So much for the big boys. At the other end of the spectrum, there were recently 929 ETFs with less than $100 million in assets each. Together, these funds account for just $20 billion, or 1.7%, of the $1.2 trillion in assets held -- even though they represent 62% of the industry in sheer numbers of funds.

Some investors in very small ETFs can get burned by wide trading spreads and low liquidity. Another pitfall is that many of the tiny funds aren't profitable for their management companies -- and thus are candidates to be closed, particularly if they aren't part of large, successful families.

In August, Russell Investments announced plans to close all but one of its 26 ETFs, after collecting more than $300 million in assets in less than two years in business.

FocusShares, a unit of the online brokerage company Scottrade Inc., has called it quits on its entire franchise of low-cost index and sector funds benchmarked to Morningstar Inc. indexes. The company closed 15 funds that had collectively attracted a little less than $100 million in assets in just over a year of business. (A previous incarnation of FocusShares, pitching four highly stylized trend-investing ETFs, closed those funds in 2008.)

Investors get their money back when a fund closes, of course. But such closures can foul up investors' tax planning and portfolio allocations.

What's in store next for ETF investors? Asset managers are tiptoeing around actively managed ETFs, but only a few firms offering bond and currency strategies have had success attracting investors to that market so far.

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(See accompanying graphic -- WSJ Sept. 5, 2012)

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THE WALL STREET JOURNAL.

Market Focus
Markets
Sterling Unfazed by Shaky U.K. Politics

By Alexandra Fletcher
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The Wall Street Journal Online
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English

Politics—once a key factor in the outlook for sterling—seems to have fallen off investors' list of worries.

When the ruling Conservative-Liberal Democrat coalition was formed after the U.K. general election in 2010, investors fretted that the alliance would fail at a time of great economic uncertainty and the subsequent sterling selloff drove the pound lower.

Now, the coalition is indeed fraying, but investors are preoccupied by economic performance, the Bank of England's next steps and, crucially, the crisis in the euro zone.

"The coalition has become very fractious, but those squabbles are minor in comparison to Europe's finance ministers having to decide whether to bail out Spain for example," said Collin Crownover, global head of currency management at State Street Global Advisors in Boston, which has $2 trillion of assets under management. "So global investors are giving U.K. politicians a free pass right now."

Serious strains started to show in the two-year-old coalition earlier this month, when Liberal Democrat Deputy Prime Minister Nick Clegg said that Prime Minister David Cameron of the Conservative Party had broken the coalition contract by failing to honor a commitment to reform the country's unelected House of Lords.

But despite the cantankerous exchanges, sterling has held on to its value, trading at a three-month high against the haven dollar. Against the beleaguered euro, it is stronger now than it has been at any point since collapse of Lehman Brothers in September 2008.

This marks a big shift in investor attitude. In May 2010, the pound slumped by more than 6% against the dollar during the two weeks following the result of the U.K. general elections amid concerns that any coalition government would likely fail, jeopardizing government efforts to rein in spending and keep the country's triple-A debt rating intact.

But now, as the euro zone crisis rumbles on and many economies face recession, local political spats just don't make the list of concerns.

"Politics really don't play such a big part in currency markets any more," said Jaco Rouw, senior investment manager at ING Investment Management in Amsterdam. "Look at Japan and Australia, where there has been intense political turmoil but the currencies are well supported because the fundamentals are strong," he said.

The fundamentals in the recession-hit U.K. provide a mixed picture. Industrial production data for June sank to a 20-year low and government borrowing continues to rise, but retail-sales data released this month surpassed expectations with a 0.3% increase on a monthly basis in July and an upwardly revised 0.8% improvement in June, helping to keep sterling healthy. In addition, the latest dreary estimates for economic growth numbers are widely expected to be raised after the first half of the year was affected by the Queen's Diamond Jubilee and the unusually bad weather.

The outlook for sterling then, according to State Street's Mr. Crownover, will be to finish the third quarter at a perky $1.57—close to current levels.

ING Investment Management's Mr. Rouw and Abi Oladimeji, a London-based portfolio manager and investment strategist at Thomas Miller Investment, also think sterling is trading at a realistic level against the dollar and the euro.

If anything hits the pound now it is most likely to be the euro-zone crisis, which could spiral into chaos again if the European Central Bank disappoints investors who are hoping for intervention in the debt markets to help fiscally frail member countries such as Spain and Italy.

"The currency markets are so interlinked that to make a call on sterling, you must also consider the outlook for the euro against the dollar rate," Mr. Oladimeji said. "If the crisis worsens and there is a big spike in risk aversion, one would expect to see a decline in the value of the euro against the dollar and therefore a decline in the value of sterling."

Even if the Cameron-Clegg coalition were to fall apart, investors expect little more than a brief sterling selloff.

"Our clients do have concerns about the coalition, but if it were to break down, we would probably only see a temporary knee-jerk reaction downward in sterling," Mr. Crownover said.

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Global Finance: Fidelity Targets Securities Lending

By Kirsten Grind and Jason Zweig
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Mutual-fund company Fidelity Investments is setting itself on a collision course with rivals by rolling out a pricing service designed to make the roughly $800 billion market for securities lending more transparent, according to people familiar with the firm's plans.

In securities lending, money managers lend out stocks and bonds, frequently to short sellers, collecting a fee for the service. The short sellers, who want to bet against the securities, sell them, hoping to buy them back later at a lower price and return them, pocketing the difference as profit.

Mutual funds, pension funds and other big asset managers long have engaged in securities lending from the portfolios they manage for investors. But the industry is dominated by big custodial banks that provide safekeeping of financial assets, such as Bank of New York Mellon Corp., State Street Corp. and Northern Trust Co., as well as by investment banks like Goldman Sachs Group Inc. and J.P. Morgan Chase & Co.

Fidelity, the country's third-largest mutual-fund company by assets behind Vanguard Group Inc. and American Funds, joins a number of asset managers expanding into business lines dominated by big Wall Street firms. BlackRock Inc. is testing an electronic-trading platform that will bypass investment banks by linking buyers of corporate bonds directly with sellers. Other fund firms, including State Street, have been exploring a broader electronic bond-trading platform.

Most securities lending takes place between firms. Fidelity's pricing service, which doesn't yet have a name, will allow hedge-fund clients of Fidelity's brokerage operations to compare lending rates from various Wall Street firms, including Fidelity, at the same time. The function isn't offered by other large prime brokers. Fidelity isn't planning to charge a fee for the service; the only requirement is that users be Fidelity clients.

"We are engaging in a variety of initiatives to bring transparency to opaque markets," said Brian Conroy, president of Fidelity Capital Markets.

The service could be the first step toward establishing an electronic-trading platform that could further disrupt the business, though Fidelity has no formal plans to develop one now, according to people familiar with the company's strategy.

If borrowers can compare rates more easily, brokers could have a tougher time charging higher rates. Already, Fidelity has met resistance, with at least one brokerage firm declining to provide its rates, according to a person familiar with the company's strategy. Other competitors worry that the move will make rates more uniform as Fidelity exposes discrepancies between what firms are charging.

"It's such a competitive environment that I think it will stir things up," said an executive at another brokerage firm.

As of March 30, $335 billion in U.S. stocks, $373 billion in Treasury securities and $73 billion in U.S. corporate bonds were out on loan, according to Data Explorers, a research firm that tracks securities lending.

In the first quarter of 2012, the average return on lendable securities was 0.06%, according to Data Explorers. But rates range widely across firms. Borrowers and lenders often complain they can't tell whether their transactions are being priced fairly, according to industry observers.

"Price transparency is a big issue these days," said Joe Pellegrini, vice president of business development at the Options Clearing Corp., which facilitates securities-lending transactions.

Fidelity is testing the service among eight of its hedge-fund clients and anticipates launching it sometime in the next two months. Ted Seides, president of Protege Partners, a firm that specializes in assembling portfolios of smaller hedge funds, said Fidelity has approached several managers in the past few months to gauge interest.

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English

Twitter Leaves Business

Market to Others

Twitter Inc., already a powerful advertising and marketing tool, is only just beginning to evolve as a multifaceted platform for corporate communications, Twitter CEO Dick Costolo says.

However, he expects to see outside developers take the lead in creating enterprise applications for the Twitter ecosystem.

"It would be natural to see more CRM innovation, more analytic tools . . . more sentiment analysis tools . . . I can imagine a lot of internal, enterprise applications," Mr. Costolo said Monday during a meeting with Wall Street Journal editors and reporters.

Twitter has no intention of developing such corporate communications tools on its own, though. "We are not focused on internal (corporate) communications at all," he said.

Mr. Costolo also said Twitter has no intention of forcing users to reveal their identities, which is a basic condition for operating in a corporate environment.

"We are the free speech wing of the free speech party," Mr. Costolo said.

And while that policy might make it more difficult for Twitter to amass demographic data, Mr. Costolo said the policy benefits Twitter users, which justifies the tradeoff.

As for Twitter developers, Mr. Costolo urged them to move up the value chain. There already are plenty of apps for viewing tweets.

What's needed now, he said, are more tools for complex tasks such as sentiment analysis, which helps companies keep track of what people are saying about them on Twitter, analyze those patterns, and respond.

-- Steven Rosenbush

Gartner: Directors Plan

To Boost IT Spending

Corporate boards view information technology as a top investment priority, second only to sales, according to a new study from Gartner and Forbes, released Monday.

The survey of 175 board members shows the climate of board rooms might bode well for CIOs looking to push for bold initiatives.

The poll found that despite their pessimistic view of the economy, 64% of respondents at companies, with more than $250 million in sales, plan to increase their investments in IT.

The directors also want CIOs to play a more transformative role in the company, with 86% saying they expect IT to make a greater strategic contribution over the next two years.

"It is clear that CIOs are being asked to play a different role," said Jorge Lopez, Gartner analyst and lead author of the study. "It used to be that the biggest role of the CIO was on operations. Now they're looking for someone who can impact revenue."

-- Joel Schectman

State Street Views Its

Cloud as a Rainmaker

State Street Corp. is building a private cloud network that will allow its customers to host their data on the company's computer systems, said State Street CIO Chris Perretta.

The move is a key part of State Street's effort to cut $600 million in costs and position the company for accelerated growth.

Mr. Perretta said State Street expects to charge customers to run their own applications on the company's cloud, providing a new revenue stream for the asset manager.

That move would put State Street in competition with cloud providers such as Amazon.com Inc., Microsoft Corp., and other companies.

Commercialization of the cloud is still a couple of years away, though, and Mr. Perretta declined to say how much revenue the associated business opportunities were expected to generate. "We're not ready to announce them but they are there," Mr. Perretta said.

-- Clint Boulton

CIO Journal is a Wall Street Journal news service for business-technology executives. For more, please visit blogs.wsj.com/cio

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Business
BNY Mellon Profit Falls as Northern Trust Bucks Downtrend

By Liz Moyer And Victoria Stilwell
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Bank of New York Mellon Corp.'s second-quarter profit fell 37% as lower revenue and a $350 million pretax litigation charge weighed on the trust bank's earnings.

As the firms that run the behind-the-scenes activities that make Wall Street and banks run, trust banks are feeling the effects of the market doldrums. Rival trust bank State Street Corp. on Tuesday reported its second-quarter earnings fell 4.5% as the company posted lower revenue.

"There's no question that transaction volumes are lower," Todd Gibbons, Bank of New York Mellon's chief financial officer, said in an interview. "Investors are cautious, interest rates are low. It's not a great environment."

Revenue fell 6.1% to $3.62 billion, and fee revenue fell 8%, to $2.78 billion. Foreign-exchange and other trading revenue fell 19%, to $180 million. Investment management fees rose 2.3%, to $797 million, driven by higher performance fees.

The results were well below analysts' forecasts, largely because the estimates didn't include the litigation charge. For the second quarter, BNY Mellon posted earnings of $466 million, or 39 cents a share, down from year-earlier earnings of $735 million, or 59 cents a share. Analysts polled by Thomson Reuters had estimated per-share earnings of 53 cents.

Bank of New York Mellon earlier this month said it would take the $350 million pretax charge, or 18 cents a share, in the second quarter, mostly to settle a lawsuit by investors who accused the bank of putting them in a risky debt security that collapsed during the financial crisis. The settlement concerns the late 2008 collapse of a $27 billion structured investment vehicle called Sigma Finance Corp.

Assets under management, excluding securities lending assets, rose 2% to $1.3 trillion as of the end of the quarter, while assets under custody and administration increased 3% to $27.1 trillion.

The provision for credit losses was a credit of $19 million, mostly resulting from a decline in the expected loss related to a broker-dealer customer that filed for bankruptcy as well as improvements in the mortgage portfolio. There was a $5 million provision in the first quarter and no provision a year ago.

Separately, Northern Trust Corp. bucked the trend that beset Bank of New York Mellon and State Street, as second-quarter earnings climbed 18% on an increase in revenue and a sharp drop in net charge-offs.

Net interest income climbed 3% in the second quarter from a year earlier despite the historically low interest rates. New business from financial institutions aiming to cut costs by outsourcing their activities has helped boost fee revenue. Fees from trust, investment and other services increased 8.6% to $605.8 million, accounting for 61% of the company's second-quarter revenue.

For the second quarter, Northern Trust reported a profit of $179.6 million, or 73 cents a share, up from $152 million, or 62 cents a share, a year before. The most-recent quarter included restructuring, acquisition and integration-related charges of 1 cent per share while the year-ago quarter included an 8 cent per-share impact due to similar expenses.

Revenue rose 4.6% to $988.5 million and includes the benefit of acquisitions completed in June and July of 2011. Analysts surveyed by Thomson Reuters recently expected earnings of 75 cents a share on revenue of $1 billion.

Assets under custody rose 3.4% to $4.563 trillion while assets under management increased 3% to $704.3 billion.

Provision for credit losses was $5 million, down from $10 million a year before. Net charge-offs—loans lenders don't expect to collect—totaled $3.2 million, down from $15 million a year earlier.

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Business
Goldman Sells Back-Office Arm to State Street

By Juliet Chung and David Benoit
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Goldman Sachs Group Inc. agreed to sell its hedge-fund administration arm to State Street Corp. for $550 million, the latest deal in an industry where high costs and increased regulatory scrutiny have sparked a merger wave.

The acquisition positions State Street as the biggest provider of accounting and other back-office functions to the hedge-fund industry, the firms said, and will begin adding to the trust bank's profit within a year of the deal's close, expected during the fourth quarter.

Goldman's sale is the latest within the still-fragmented industry of hedge-fund administrators, which help set asset values, reconcile trades, process investors' requests to add or pull money from funds and perform other back-office functions.

SS&C Technologies Holdings, Inc. said last month it bought GlobeOp Financial Services SA In September, Wells Fargo & Co. acquired Cargill's hedge-fund administration arm, which in 2010 had bought Bank of AmericaMerrill Lynch's administration business. Citadel LLC last year sold its administration arm, Omnium LLC, to Northern Trust.

The high costs of maintaining state-of-the-art back-office systems will continue to drive consolidation, said Chris Throop, head of business consulting at Bank of AmericaMerrill Lynch prime brokerage, who advises the bank's hedge-fund clients in choosing fund administrators.

Mindful of the Madoff scandal, hedge-fund investors increasingly have pushed firms to hire outside service providers to keep their books. Some of those clients also urge hedge funds to avoid hiring prime brokers to handle their accounting, Mr. Throop said.

"Investors are saying, 'We've been burned, we're looking for strong, independent service providers at every key point, and we want separation of church and state wherever possible,'" he said.

For Goldman, the unit was a relatively small business that doesn't impact its ability to continue catering to hedge funds as a prime brokerage unit, which the firm views as an important business.

"There was not a lot of revenue and earnings associated with it," David Viniar, Goldman's chief financial officer, said of the business in a call with analysts Tuesday.

Sandler O'Neill & Partners analysts wrote Tuesday that the sale made "strategic sense" as the unit's $200 billion in assets under administration had become "subscale." The Goldman business served "some of the best names in the hedge-fund space," said George Sullivan, global head of State Street's alternative investment solutions group.

Goldman has had some headaches from similar operations that handle basic functions for hedge funds and brokerages.

Earlier this month, Goldman lost a court ruling that upheld an order requiring the firm to pay $20.6 million to the unsecured creditors of failed hedge fund Bayou Group LLC. Bayou's creditors had accused a Goldman clearing unit of ignoring signs of fraud at the hedge fund run by Samuel Israel III before it imploded in 2005. They took the matter to arbitration and won the award in a June 2010 decision. It has now been upheld by two federal rulings.

Goldman has also paid out $7 million to settle allegations its brokerage clearing arm had failed to "diligently supervise" some clients. Goldman didn't admit or deny the allegations.

Neither of those fines related to the business being sold, but the increasing scrutiny has made back-office operations less attractive for Goldman, a person familiar with the matter said.

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THE WALL STREET JOURNAL.

Markets

State Street Profit Slips

By Liz Moyer
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State Street Corp.'s second-quarter earnings fell 4.5% on lower foreign-exchange trading revenue and lower fees from investment management and servicing.

The Boston-based company is one of the country's largest trust banks, acting as a custodian for investment firms' securities and handling other back-office duties. Like many financial firms, the company's top and bottom lines have been pressured by historically low interest rates and declining trading volumes.

Chairman and Chief Executive Joseph L. Hooley said State Street was approaching the second half cautiously, noting that the latest quarter benefited from lower compensation costs and overall expense controls.

In investor presentations this year, Mr. Hooley has emphasized that much of the firm's opportunities will come from growth abroad, from expanding client relationships in outsourcing and other services, and in alternative investments.

Earlier Tuesday, State Street said it struck a deal to buy Goldman Sachs Group Inc.'s hedge-fund administration business for $550 million, making it the biggest player in the relatively mundane business of managing behind-the-scenes activities for hedge funds, including tax reporting and accounting.

Goldman administers $200 billion of assets for hedge funds, adding to State Street's nearly $900 billion portfolio. In an interview Tuesday, Mr. Hooley said the business brings some "very attractive" hedge-fund customers to which State Street can sell other services, including investments.

Operating revenue fell 1.9% from last year, to $2.4 billion. Total fee revenue fell 6% from last year, to $1.8 billion. Trading-services revenue fell 18% from last year, to $255 million, as foreign exchange trading revenue dropped 24%.

While analysts pointed to a 6.6% reduction in compensation and employee benefits compared to last year, helping to push operating expenses down 2%, news of the weakened financial performance weighed on the stock. Shares of State Street were down around 5% in midday trading.

In the interview, Mr. Hooley said the firm, like other banks, was proceeding cautiously, particularly in Europe, where volatility and concerns about sovereign debt continue to roil the markets.

Certain trends indicate growth for the firm, he said, pointing to rising savings rates and growing corporate cash coffers that will eventually be invested. "There needs to be more confidence; for firms to be able to put up a couple of solid quarters," he said.

State Street reported a profit of $490 million, or 98 cents a share, down from $513 million, or $1 a share, a year earlier. Excluding a loss on the sale of Greek investment securities, acquisition and restructuring charges and litigation settlement costs, earnings were up at $1.01 from 96 cents.

Analysts polled by Thomson Reuters most recently projected earnings of 97 cents on revenue of $2.42 billion.

Tess Stynes contributed to this article.

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THE WALL STREET JOURNAL.

Markets

Exchange-Traded Funds; ETFs for High-Yield Exposure; Junk-bond portfolios offer income and low expenses, but watch out for premium prices

By Steven Rosenbush
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Many investors on the hunt for higher-yielding alternatives to Treasury bonds and investment-grade corporate credit have fixed their sights on exchange-traded funds that invest in junk bonds.

ETFs of below-investment-grade debt didn't exist until about five years ago, when BlackRock Inc.'s iBoxx High Yield Corporate Bond and State Street Corp.'s SPDR Barclays Capital High Yield Bond came into being. Now the market for high-yield ETFs has grown into a $28 billion sector, with assets up $12 billion over the past year, according to Morningstar Inc. These two funds together account for about 90% of the assets, but during the past year, about half a dozen new players have emerged, some of them specializing in illiquid markets outside the U.S.

"There is strong—very strong—growth in high-yield ETFs, which isn't surprising," says Morningstar analyst Timothy Strauts. A big part of the appeal: yields of around 7%.

Meanwhile, the default rate on below-investment-grade debt has dropped since the height of the credit crisis, to 2.2% in May from almost 13.7% in 2009, according to Fitch Ratings.

The question for investors who are seeking exposure to the high-yield market and are willing to tolerate its inherent risk—closer to that of stocks than, say, investment-grade bonds—is one of access. For most individuals, the choice is between ETFs and conventional mutual funds.

Here are some factors to consider in making that decision:

Passive vs. Active: The vast majority of ETFs are pegged to an index, while high-yield mutual funds are generally actively managed. The indexing approach typically means lower fees, but New York financial adviser Lewis J. Altfest says he, for one, "would prefer a fund that is actively managed by someone who knows the market." He says high-yield bonds can face sharp and abrupt shifts in pricing, creating opportunities to beat the market that don't exist in more efficiently traded assets, such as large stocks.

Cost: Junk-bond ETFs aren't as cheap as ETFs that track major stock indexes, but their expenses generally are lower than those of high-yield mutual funds. The iBoxx ETF, often known by its ticker, HYG, has annual expenses of 0.5% of assets, while the SPDR fund, with the ticker JNK, is at 0.4%. The average net expense ratio for the 630 high-yield mutual-fund share classes tracked by Morningstar is 1.16%.

However, ETF investors can face commissions to buy and sell shares. Among mutual funds, Vanguard High-Yield Corporate is a low-cost standout at an expense ratio of 0.23%, but the fund is currently closed to new investors.

ETF Price vs. NAV: Mutual funds trade once daily, based on the end-of-day net asset value, or per-share value of the fund holdings. By contrast, ETFs trade on exchanges, and there is often a difference between the price of an ETF share and its NAV.

Those variations from NAV have narrowed over the past few years, says Kevin Quigg, global head of ETF strategy and consulting for State Street Corp.'s SPDR ETF family. For example, he says JNK traded at a premium of three cents to NAV in early 2009, when credit markets were frozen. That spread has narrowed to one cent a share, he says, citing data from NYSE's Arcavision trading platform.

The downside: ETF investors can end up with a lower return than they expected if, for instance, they buy at a sizable premium to NAV but end up selling at a smaller one. This year, through June 30, JNK returned 6.1%

based on its NAV but 5.8% based on its price, according to Morningstar. The gap is wider, 6.1% vs. 5.1%, for HYG.

The difference between the ETF and mutual-fund structures may have important meaning in the event of a market panic, too. Since most ETF investors buy and sell to one another in the secondary market, ETFs, unlike mutual funds, can't be forced to sell holdings to satisfy a rush of investors who want to cash out. But ETFs can see their shares fall to a steep discount to NAV. In a crunch, ETF investors can sell intraday. However, the inability to sell mutual-fund shares on an intraday basis can work to the advantage of investors who might end up better off staying the course when prices are tumbling, Mr. Altfest says.

Tracking Error: A related issue that applies to ETFs is that a fund's portfolio may not move exactly in sync with the underlying index. The junk-bond market is one area in which there are many securities that trade infrequently, so rather than hold all the securities in a high-yield index, index funds often buy a selection of bonds they hope will perform in line with the overall benchmark. HYG, for example, recently held 614 of the 639 securities in its index, says Morningstar.

Resulting variations in performance, along with the fund's operating costs, produce tracking error, which is the amount by which funds miss or exceed the performance of their benchmark. HYG trails its benchmark by 0.51 percentage point a year since inception, of which almost all is explained by the expense ratio. But there have been periods when the tracking error was much greater. In 2009, for example, HYG gained 40.7% while the index returned 44.6%. That year, the most illiquid securities in the index had the best performance, Morningstar's Mr. Strauts says.

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An Index-Fund Pioneer Bowing Out at Vanguard

By Kirsten Grind
438 words
23 June 2012
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English

George "Gus" Sauter, a pioneer of index investing who is widely credited with building Vanguard Group Inc.'s exchange-traded fund operation, will step down as chief investment officer at the end of the year, the company announced on Friday.

Mr. Sauter, a 25-year veteran of the firm, led Vanguard into the ETF business in 2001. Today the firm has about $200 billion in ETF assets.

Vanguard now ranks as the third-largest provider with 17.5% of the U.S. market share for ETFs, after BlackRock Inc.'s iShares division and State Street Corp., according to fund researcher Morningstar Inc.

Exchange-traded funds are mutual funds that generally track a stock or bond index and are traded on public exchanges.

Mr. Sauter, who has held the position of chief investment officer for nine years, said he has no immediate plans. Mortimer "Tim" Buckley, managing director of Vanguard's retail investor group, will succeed Mr. Sauter, the company said.

When Mr. Sauter, now 57 years old, started at Vanguard as head of the firm's internal equity management group in 1987, 4% of Vanguard's mutual-fund assets were pegged to indexes. Today that figure is about 58%, according to the company. Mr. Sauter developed new index-trading programs and pushed to expand Vanguard's lineup of index products.

In 1998, Mr. Sauter pitched to his bosses the idea of setting up a separate ETF share class in an existing mutual fund, allowing investors to avoid paying taxes if they decided to trade their mutual fund shares for shares in the ETF.

He got a cool reception. At that point, there were just 29 ETFs, according to Morningstar. Now there are 1,472.

"He said, 'We need to do this -- it's going to be a way for a broader group of people to get exposure to indexing,'" Vanguard Chief Executive F. William McNabb III said of Mr. Sauter's role in building the ETF business. "He was the internal champion."

After his initial skepticism, Vanguard's then-Chairman and Chief Executive, John "Jack" Brennan, approved it, Mr. Sauter said. The firm applied for and received a patent for the ETFs, and launched its first one, the Vanguard Total Stock Market ETF, in 2001.

The ETF now has $20.7 billion in assets. All told, Vanguard has 64 ETFs.

"I believe we each have the ability to take things so far, and then someone else needs to carry it beyond that," Mr. Sauter said of his planned departure.

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US
Women, Welch Clash at Forum

By John Bussey
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Is Jack Welch a timeless seer or an out-of-touch warhorse?

The former Master and Commander of General Electric still writes widely on business strategy. He's also influential on the speaking circuit.

On Wednesday, Mr. Welch and his wife and writing partner, Suzy Welch, told a gathering of women executives from a range of industries that, in matters of career track, it is results and performance that chart the way. Programs promoting diversity, mentorships and affinity groups may or may not be good, but they are not how women get ahead. "Over deliver," Mr. Welch advised. "Performance is it!"

Angry murmurs ran through the crowd. The speakers asked: Were there any questions?

"We're regaining our consciousness," one woman executive shot back.

Mr. Welch had walked into a spinning turbine fan blade.

"Of course women need to perform to advance," Alison Quirk, an executive vice president at the investment firm State Street Corp., said later. "But we can all do more to help people understand their unconscious biases."

"He showed no recognition that the culture shapes the performance metrics, and the culture is that of white men," another executive said.

Dee Dee Myers, a former White House press secretary who is now with Glover Park Group, a communications firm, added: "While he seemed to acknowledge the value of a diverse workforce, he didn't seem to think it was necessary to develop strategies for getting there—and especially for taking a cold, hard look at some of the subtle barriers to women's advancement that still exist. If objective performance measures were enough, more than a handful of Fortune 500 senior executives would already be women. "

"This meritocracy fiction may be the single biggest obstacle to women's advancement," added Lisa Levey, a consultant who heard Mr. Welch speak.

Mr. Welch has sparked controversy in the past with his view of the workplace. In 2009, he told a group of human-resources managers: "There's no such thing as work-life balance." Instead, "there are work-life choices, and you make them, and they have consequences." Step out of the arena to raise kids, and don't be surprised if the promotion passes you by.

Of the Fortune 500 companies, only 3% have a female CEO today. Female board membership is similarly spare. A survey of 60 major companies by McKinsey shows women occupying 53% of entry-level positions, 40% of manager positions, and only 19% of C-suite jobs.

The reasons for this are complex and aren't always about child rearing. A separate McKinsey survey showed that among women who have already reached the status of successful executive, 59% don't aspire to one of the top jobs. The majority of these women have already had children.

"Their work ethic—these people are doing it all," said Dominic Barton of McKinsey. "They say, 'I'm the person turning off the lights'" at the end of the day.

Instead, Mr. Barton said, it's "the soft stuff, the culture" that's shaping their career decisions.

The group of women executives who wrestled with Mr. Welch were at a conference on Women in the Economy held by The Wall Street Journal this week. Among other things, they tackled the culture questions—devising strategies to get more high-performing women to the top, keep women on track during childbearing years, address bias, and make the goals of diversity motivating to employees. They also discussed the sexual harassment some women still experience in the workplace. (A report on the group's findings will be published in the Journal Monday.)

The realm of the "soft stuff" may not be Mr. Welch's favored zone. During his remarks, he referred to human resources as "the H.R. teams that are out there, most of them for birthdays and picnics." He mentioned a women's forum inside GE that he says attracted 500 participants. "The best of the women would come to me and say, 'I don't want to be in a special group. I'm not in the victim's unit. I'm a star. I want to be compared with the best of your best.'"

And then he addressed the audience: "Stop lying about it. It's true. Great women get upset about getting into the victim's unit."

Individual mentoring programs, meanwhile, are "one of the worst ideas that ever came along," he said. "You should see everyone as a mentor."

He had this advice for women who want to get ahead: Grab tough assignments to prove yourself, get line experience, and embrace serious performance reviews and the coaching inherent in them.

"Without a rigorous appraisal system, without you knowing where you stand...and how you can improve, none of these 'help' programs that were up there are going to be worth much to you," he said. Mr. Welch said later that the appraisal "is the best way to attack bias" because the facts go into the document, which both parties have to sign.

Mr. Welch championed the business philosophy of "Six Sigma" at GE, a strategy that seeks to expunge defects from production through constant review and improvement. It appears to work with machines and business processes.

But applying that clinical procedure to the human character, as Mr. Welch seems to want to do, is a stickier proposition.

"His advice was not tailored to how women can attain parity in today's male-dominated workplace," said one female board member of a Fortune 500 company. Indeed, a couple of women walked out in frustration during his presentation.

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Well, That Was Awkward... --- Bank Chiefs' Regulatory Concerns Met With Silence at Fed

By Dan Fitzpatrick, Liz Rappaport and Victoria McGrane
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3 May 2012
The Wall Street Journal
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English

A meeting Wednesday between a top Federal Reserve official and six bank bosses was notable largely for long silences from the central bank's side of the table.

Fed governor Daniel Tarullo met with the executives to discuss the recent "stress tests" and to hear out the banks' concerns over proposed new regulations. Mr. Tarullo and the bankers exchanged thoughts about the tests, but the Fed official didn't respond when the chief executives laid out their new-rule concerns, starting with a Fed proposal to limit the biggest banks' exposure to other firms and governments, said people familiar with the meeting.

Long-standing rules prevent the central bank from commenting on proposed regulations. Even so, the one-sided nature of that portion of the meeting is the latest example of the awkward relationship between big banks and their overseers.

Regulators and banks have been butting heads over a slew of new rules tied to the Dodd-Frank financial overhaul, such as the so-called Volcker rule that aims to limit risk taking by federally insured banks. Regulatory officials became peeved in the lead-up to Wednesday's meeting about attempts on the part of the bank CEOs to expand the agenda, according to people familiar with the situation.

At least one CEO went in with low expectations and emerged from the meeting with a lukewarm view of the event, said a person familiar with the situation.

The Fed issued a statement after the hour-and-15 minute meeting making clear that the banks had been allowed to make their case on new rules -- but that "neither governor Tarullo nor Federal Reserve staff would, during the meeting, respond or reply to views expressed by the bank representatives."

Goldman Sachs Group Inc. Chief Executive Lloyd Blankfein, J.P. Morgan Chase & Co. CEO James Dimon, Bank of America Corp. CEO Brian Moynihan and Morgan Stanley CEO James Gorman arrived with a list of items they hoped to address, including the proposed Fed rule that would limit net credit exposures between any two of the nation's six largest financial firms to 10% of a company's regulatory capital. The banks contend that rule could harm the financial system.

The meeting at the Fed's building began around 11 a.m. Some CEOs arrived via an underground garage with a police escort, and they all gathered in a 10th-floor room. Also attending were Richard Davis, chief executive of U.S. Bancorp, and Jay Hooley, CEO of State Street Corp. Citigroup Inc. CEO Vikram Pandit was invited but was in California and didn't attend.

"Legislators and regulators make policies," said Goldman's Mr. Blankfein. "But we are experts in our industry and feel a duty to advise as to what we think are the consequences of decisions and trade-offs, to the markets and to the economy. In this regard we made some points and suggestions."

Wednesday's meeting was a result of a conversation between Mr. Tarullo and J.P. Morgan's Mr. Dimon, the CEO who has been most vocal about a thicket of regulatory changes initiated since the financial crisis. Mr. Tarullo told Mr. Dimon he was scheduled to be in New York to deliver a speech and asked if Mr. Dimon could pull together the other CEOs to talk about the Fed's stress-test methods. Some banks have questioned gaps between their own internal estimates of their capital cushions and that of the central bank.

The meeting is the Fed's latest effort to gather views on new rules. Mr. Tarullo met March 30 with representatives from Americans for Financial Reform, an umbrella group of labor groups, consumer activists and liberal advocates, to discuss the Volcker rule.

Mr. Tarullo said in a speech before the Council on Foreign Relations that regulators should take "appropriate regulatory and supervisory measures" to counter risks stemming from oversight gaps in two corners of the largely unregulated financial sector known as the shadow-banking system: The money-market funds that are the source of much bank funding, particularly overseas, and the so-called tri-party repo market that is regularly tapped by large financial institutions for short-term funds.

Robin Sidel and Alan Zibel contributed to this article.

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THE WALL STREET JOURNAL.

Personal Finance
Emerging Markets: The Allure of Bonds; Advisers suggest investors look beyond stocks

By Steven Rosenbush
663 words
30 April 2012
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WSJO
English

For investors looking to diversify into emerging markets, they might be surprised to know there's more than stocks on the menu.

Instead, portfolio managers increasingly suggest emerging-market bonds as a viable alternative for investors looking to diversify their portfolios and earn higher returns than in developed markets.

"Emerging-market investors are generally more than 50% underweight in these [bond] markets," says George Hoguet, a senior portfolio manager and global investment strategist specializing in emerging markets at State Street Global Advisors.

Among the encouraging signs Mr. Hoguet and other portfolio managers point to: economic growth rates in countries like Brazil and Turkey that are four times those of the U.S.

Demand for certain types of debt is soaring. In the past 12 months, through April 16, the JP Morgan Emerging Market Bond Global Diversified Index, an index of emerging-market hard-currency debt, has returned 10.9% in dollars, while the JP Morgan U.S. Aggregate Bond Index rose 8.6% in the same period. Bonds issued in local currencies have lagged behind, though. The JP Morgan Government Bond Emerging Market Diversified Index, for example, has risen 0.57%.

Diversified Strategy

Some countries feature bond issues in both local and foreign currency. The latter, denominated, for example, in the U.S. dollar or Japanese yen, can be used to build up their hard-currency reserves, improve their balance between assets and liabilities, and support their local bond markets in general.

Mr. Hoguet favors a strategic allocation to both hard- and local-currency debt. An investor in local-currency bonds does assume currency risk, he says. But holding a portion of one's wealth in a basket of foreign currencies is advisable, he says, as a portion of one's consumption over time comes from foreign goods produced both in developed and emerging markets.

Mr. Hoguet recommends holding about 2% of an overall bond allocation in emerging-market hard-currency bonds, and about 8% in emerging-market local-currency bonds. For an overall allocation to emerging markets, Mr. Hoguet recommends 13% of equities be invested in emerging markets and about 10% of total bonds.

Another fan of emerging-market debt: Morgan Harting, senior portfolio manager and emerging-markets multi-asset team leader at AllianceBernstein Investments Inc., a unit of New York-based AllianceBernstein Holding LP. Mr. Harting says he expects "much emerging-market debt will continue to outperform, although with more volatility."

At the most basic level, Mr. Harting says, emerging-market debt offers investors higher yields than are generally available in developed markets. Yield to maturity on emerging-market debt as measured by the JP Morgan EMBI Global Diversified Index is roughly 5.37%, compared with roughly 2% for the U.S. 10-year Treasury bond.

The debt also can be used to limit volatility in the emerging-market portion of a portfolio, Mr. Harting says. In 2008, as a result of the financial crisis, emerging-market equity prices slumped 53%, he says, while emerging-market debt prices fell only 11%.

Back and Forth

When an investor likes a particular emerging market, and its debt market is strong, some advisers recommend alternating between local asset classes, depending on conditions. Mr. Harting, for example, likes Mexico because of its growth. But for now he says he can find only a few equities in Mexico that are well priced. So he has bought currency for growth and Mexican bonds for diversification.

In a riskier play, Mr. Harting also likes bonds of oil-rich Venezuela. Its debt has yields in the mid-teens—among the highest in the world. The nation's political instability, however, suggests a real risk of default. So he hedges some of the risk with credit default swaps, a form of insurance.

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Banks Push Fed on Rule

By Victoria McGrane
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B2
English

Giant banks are making a major push to blunt the impact of a proposed rule that could further constrain their trading profits.

Chief executives at some of the nation's largest banks on Wednesday plan to discuss several regulatory matters with Federal Reserve governor Daniel Tarullo, the central bank's point man on regulation, all part of the financial industry's efforts to reduce or delay the impact of regulations tied to the 2010 Dodd-Frank financial overhaul law.

Emerging as a particular concern is a Fed proposal to limit the biggest banks' exposure to other firms and governments, which the banks contend could reduce liquidity in the financial system, dragging down economic growth.

In a letter from five major financial trade associations submitted to the Fed on Friday, bankers said the rule is based on "unrealistic" methodology and could foster "potentially destabilizing" market shifts.

Comments on the proposed rule, which the Fed proposed in December, are due Monday. The Fed isn't expected to produce a final rule for several months.

Big banks with large derivatives businesses face particular pain under the draft rule, because it would limit net credit exposures between any two of the nation's six largest financial firms to 10% of a company's regulatory capital.

Banks are urging the Fed to scrap the 10% limit, arguing that all financial institutions should be subject to the 25% limit would govern most other firms covered by the rule. The Dodd-Frank law set the 25% threshold, though it said the Fed could go beyond that if regulators believed it necessary.

In proposing the rule in December, the Fed said the single-counterparty exposure limits aim to reduce the interconnectedness of the U.S. financial system.

The 2008 financial crisis showed links among major institutions could destabilize the entire economy and lead to costly countermeasures, as illustrated by the collapse of Lehman Brothers Holdings Inc., the subsequent rescue of American International Group Inc. and passage of the $700 billion Troubled Asset Relief Program.

Friday's letter, written jointly by the Clearing House, the American Bankers Association, the Financial Services Roundtable, the Financial Services Forum and the Securities Industry and Financial Markets Association, strikes an aggressive stance on the issue, arguing that the Fed hasn't shown any evidence, as required by the law, to prove the lower cap is necessary.

The counterparty credit limit presents a bigger threat to foreign governments' ability to sell their debt than the Volcker rule, a high-profile piece of the overhaul legislation that aims to limit risk-taking by federally insured banks, said one industry executive.

Banks, foreign governments and other financial-industry players submitted thousands of pages of objections to the rule earlier this year, and the Fed recently clarified that it wouldn't enforce that rule for two years.

The banks also want the Fed to exempt certain "high-quality" government bonds from counting against the credit limit, just as U.S. Treasurys are exempt. Industry lobbyists have been reaching out to foreign embassies and are expecting foreign governments, especially in Europe, to put pressure on U.S. regulators.

Wednesday's meeting, which is expected to cover the counterparty rule, is expected to include chief executives from Goldman Sachs Group Inc., Morgan Stanley and Bank of America Corp., the people said. Representatives of the banks didn't comment. It was organized by J.P. Morgan Chase & Co. Chief Executive James Dimon at Mr. Tarullo's request and will be held at the bank, according to people familiar with the situation.

Friday's letter is one of several submissions criticizing the Fed rule that are expected ahead of the comment deadline. Another letter is expected to come from the Risk Management Association, another financial-industry group. Officials from Goldman Sachs, J.P. Morgan, Bank of New York Mellon Corp., Northern Trust Corp. and State Street Corp. discussed final revisions to that letter on Thursday with lawyers from Debevoise & Plimpton LLP.

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Probes Nip Banks' Profits --- BNY Mellon, State Street See Revenue Slide Amid Currency-Trading Allegations

By Jean Eaglesham
1,013 words
19 April 2012
The Wall Street Journal
J
C1
English

Profit at two big banks is being pinched by allegations they overcharged clients for currency trades, analysts said.

Bank of New York Mellon Corp. and State Street Corp. this week reported lower foreign-exchange revenue for the first quarter, as they battle law-enforcement probes examining whether they allegedly defrauded investors by systematically overcharging them on currency trades. Both banks deny wrongdoing.

BNY Mellon, which is fighting lawsuits filed by six states seeking a total of more than $2 billion in damages in the matter, reported Wednesday that first-quarter revenue from foreign-exchange trading was $136 million, down 21% from the year-earlier period. State Street, which faces suits from two states, said Tuesday that its foreign-exchange revenue was $149 million for the first quarter, down 7% from a year earlier.

"The big juicy spreads" from foreign-exchange trading "are a thing of the past," said Brad Hintz, an analyst at Sanford C. Bernstein & Co.

Executives at both banks said the state pension funds, corporations and other firms that use their currency-trading services aren't defecting en masse in response to the fraud allegations. The banks said the revenue dips primarily were a result of trading conditions. State Street said its volume of currency trades was up from the previous quarter, while BNY Mellon said volume was unchanged.

Another factor is at play: Customers are demanding better exchange rates on currency deals, as a result of the publicity surrounding the suits, the analysts said. This is squeezing the banks' profits on these trades, they added. BNY Mellon and State Street declined to comment on profit margins for foreign-exchange trading.

BNY Mellon's first-quarter earnings fell 1% from a year ago, to $619 million; State Street's first-quarter earnings fell 9%, to $427 million.

The banks are being pressured by investors and others to be clearer about pricing. BNY Mellon this year agreed to stop describing its currency-trading service as "free," as part of a settlement of some of the charges in a civil lawsuit filed last year by the Manhattan U.S. attorney's office.

Gerard Cassidy at RBC Capital Markets said the "customer outcry over selected foreign-exchange trading practices has affected prices," adding he expects future profit margins on the business to be lower.

The two custody banks, which handle back-office work and execute currency trades for institutional investors, are fighting the suits. At issue in the allegations is a type of currency trading called "nonnegotiated" or "standing-instruction." This is when pension funds and other clients allow the bank unilaterally to handle foreign-exchange transactions. The customers could instead negotiate their own trades, but this requires staff and technology. It also can be inconvenient for small trades or obscure currencies.

A spokesman for BNY Mellon said the bank's "standing-instructions program is a valuable service offered in a highly competitive foreign-exchange trading marketplace."

"Standing instruction continues to have strong utilization across the client base given wholesale pricing for retail size transactions and, in fact, volumes have increased in each of the last two years. We continue to introduce innovative pricing and reporting options to meet our clients' evolving needs," BNY Mellon said.

A State Street spokeswoman said, "State Street continues to cooperate with inquiries regarding our indirect FX services and vigorously defend the litigation that has been commenced against us. We offer clients and their investment managers a range of FX execution options."

Fidelity Investments said it uses BNY Mellon and other custodial banks for foreign-exchange trades on behalf of its clients "on a limited basis, typically for restricted currencies that present logistical and operational hurdles." A spokesman for Fidelity declined to comment on how much it pays for these services. But he signaled the rates are better than they used to be in the past.

Fidelity has cut foreign-exchange costs "over time" by avoiding using the standing-instruction service where possible and "seeking to limit the discretion exercised by custodians over the terms" on which standing-instruction deals are done, the spokesman said in an emailed statement.

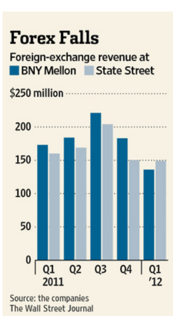
BNY Mellon and State Street face allegations that they used their discretion over the pricing of standing-instruction trades to increase profits by using exchange rates that disadvantaged clients. When certain customers became aware of this and complained, they were allowed to opt out of the normal standing-instruction pricing, according to a suit filed by the Florida state attorney general last year against BNY Mellon. The bank is fighting the lawsuit.

Some customers have managed to get rebates by protesting the rates, according to the civil suit filed last year by the Manhattan U.S. attorney. New Jersey's Department of the Treasury won a rebate of about $100,000 in late 2005 or early 2006 after it "confronted BNY Mellon . . . that it seemed as though the bank was price gouging," the lawsuit said. Representatives for New Jersey and BNY Mellon declined to comment.

Other clients were given false reassurances on currency pricing, the Manhattan U.S. attorney suit alleged. Prudential Financial Inc. in February 2011 was told by BNY Mellon that all standing-instruction clients got the same pricing terms, according to the suit. "Prudential would have looked elsewhere for foreign exchange services had BNYM been truthful," the suit said. A spokesman for BNY Mellon declined to comment, as did a spokeswoman for Prudential.

More states are questioning the terms of the contracts for their pension funds' custody business. Connecticut this month announced plans to review trades done by State Street, to help with "potential litigation." A spokeswoman for Connecticut said the review is at the fact-finding stage. A spokeswoman for State Street said Connecticut "remains a valuable client."

But the convenience of the custody relationship means the banks likely will keep most of their foreign-exchange business, even if it has to be priced less profitably, according to analysts.



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Markets
Probes Nip Banks' Profits; BNY Mellon, State Street See Revenue Slide Amid Currency-Trading Allegations

By Jean Eaglesham
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18 April 2012
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English

Profit at two big banks is being pinched by allegations they overcharged clients for currency trades, analysts said.

Bank of New York Mellon Corp. and State Street Corp. this week reported lower foreign-exchange revenue for the first quarter, as they battle law-enforcement probes examining whether they allegedly defrauded investors by systematically overcharging them on currency trades. Both banks deny wrongdoing.

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But the convenience of the custody relationship means the banks likely will keep most of their foreign-exchange business, even if it has to be priced less profitably, according to analysts.

The $232 billion California Public Employees' Retirement System last summer renewed its contract with State Street to do its custody work, despite the state suing the bank in 2009 for allegedly defrauding the fund. A spokesman for Calpers declined to comment. A spokeswoman for State Street said the bank continued to "vigorously defend the claims made in California."

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Business
Profit Diverges at Trust Banks

By Melodie Warner
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English

Earnings and fees fell at State Street Corp. but rose at Northern Trust Corp., two of the nation's largest trust banks.

State Street, which acts as a custodian for investment firms' securities and handling other back-office duties said first-quarter earnings fell 9.3% on lower fees and revenue from trading services.

But Northern Trust's first-quarter earnings rose 6.8% as strong new business and higher equity markets helped boost the trust bank's fee revenue.

Both companies have seen profits challenged by interest rates remaining at historical lows.

In the first quarter, State Street reported a profit of $427 million, or 85 cents a share, down from $471 million, or 93 cents, a year earlier. Excluding items, earnings fell to 84 cents from 88 cents. The most-recent quarter included acquisition and restructuring costs of 3 cents a share and 2 cents a share for litigation-related settlements. Revenue rose 2.5% to $2.42 billion.

Analysts polled by Thomson Reuters had most recently forecast earnings of 86 cents on revenue of $2.33 billion.

Servicing fees were down 2% to $1.08 billion, reflecting weakness in non-U.S. markets.

Trading-services revenue, which includes foreign-exchange trading revenue and brokerage and other fees, declined 7% to $280 million. Foreign-exchange trading revenue decreased 7%, while brokerage and other fees were down 8%.

Securities finance revenue jumped 47% to $97 million as higher spreads partially offset lower volume.

The company also has a major investment management arm, State Street Global Advisors, whose clients include nonprofit organizations, corporations and pension funds. In the latest period, investment management fees at Global Advisors totaled were flat at $236 million.

Total assets under management as of at March 31, were $1.993 trillion, down 6% from a year ago.

At Northern Trust, net interest income climbed 8.7% from a year earlier. Fees from trust, investment and other services rose 12% to $575.2 million, accounting for 60% of the company's first-quarter revenue.

Northern Trust reported a profit of $161.2 million, or 66 cents a share, up from $151 million, or 61 cents, a year earlier. The most-recent quarter included restructuring and integration related charges of 1 cent a share, while the year-earlier quarter included restructuring and integration related charges of 2 cents a share and a 2-cent gain from indemnified litigation involving Visa Inc.

Total revenue jumped 7.5% to $965.4 million. Analysts polled by Thomson Reuters had most recently forecast earnings of 66 cents on revenue of $974 million.

Assets under custody rose 5.5% to $4.595 trillion while assets under management increased 8.2% to $716.5 billion.

Provision for credit losses was $5 million, down from $15 million a year earlier. Net charge-offs, or loans that lenders don't expect to collect, were $5.8 million, down from $21.6 million a year ago.

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Personal Finance
CEO Pay Is Still Robust at Big Asset Managers

By Kirsten Grind
998 words
21 March 2012
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The Wall Street Journal Online
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English

Regulations and volatile financial markets are hitting many Wall Street chief executives hard in their wallets. But the CEOs of three of the largest asset-management firms in the U.S. have escaped the damage.

Total compensation for chief executives at Federated Investors Inc., Franklin Resources Inc. and T. Rowe Price Group Inc. rose 28% to a combined $22.4 million in 2011, according to securities filings. All three got a boost from incentive-based pay, in contrast to smaller bonuses atop many banks and securities firms.

Federated, Franklin and T. Rowe Price are among the seven largest publicly traded asset managers in the U.S. Some compensation experts are predicting similar increases when rivals such as Invesco Ltd. and State Street Corp. disclose pay details in the next several weeks. State Street and Invesco declined to comment.

Asset management is a diverse industry with diverse players. The industry leader, BlackRock Inc., operates much like an investment bank, and its CEO saw his total compensation fall. In addition, company-specific issues can affect compensation. CEO compensation at another large asset manager, Janus Capital Group Inc., fell after the executive got a big compensation package in 2010.

But for Federated, Franklin and T. Rowe Price, the differences in their compensation and that of their investment-banking counterparts are a reminder that there are advantages to avoiding too much volatility. Asset-management firms make their money primarily by managing mutual funds, where fees have been steady and asset levels generally stable despite last year's topsy-turvy markets.

The same uncertainty last year slammed bonuses for traders and investment bankers, who get a larger chunk of compensation from variable-based pay than asset-management employees do. Banks and securities firms also are being squeezed more by new rules.

As a result, T. Rowe Price's president and chief executive, James A.C. Kennedy, saw his total compensation climb 11% in 2011 to $7.9 million from $7.1 million in 2010.

The increase came from bigger stock-option awards and other incentive-based compensation. The company left Mr. Kennedy's salary at $350,000 a year.

A company spokesman said Mr. Kennedy got a "modest increase in total compensation" because the firm "financially did reasonably well." The Baltimore company's profit rose 15%. T. Rowe Price also considered the company's "strong financial position" under Mr. Kennedy, including no debt.

Bonuses for rank-and-file employees at asset and wealth-management firms, including privately held companies, were expected to increase about 5% for 2011, according to Johnson Associates Inc., a compensation consultant in New York. Such bonuses were expected to fall 20% to 40% at the biggest U.S. commercial and investment banks.

Not every asset manager is sending the CEO home with more than it did in 2010.

Janus, the 10th-largest publicly traded asset manager, reported in its proxy that CEO Richard M. Weil earned $6.2 million in salary, bonus and stock in 2011 after earning $10.3 million in 2010, his first year at the company. He also earned a $10 million sign-on bonus that year, prompting shareholders in 2011 to vote down management's compensation plan. The company's net income fell 11% in 2011 to $142.9 million, in part because its mutual-fund lineup is weighted heavily toward stocks.

And on Friday, BlackRock said total compensation for Chairman and Chief Executive Laurence D. Fink shrank 8% to $21.9 million. Mr. Fink's bonus fell 20% to $8.1 million. BlackRock's businesses include private-equity investing and hedge funds, which face higher capital requirements and will be forced to change how they trade some securities.

There are few signs that asset managers with higher overall pay or bonuses will face a backlash at coming shareholder meetings, like Janus saw last year.

While some investors might be concerned about the increases, "there really haven't been huge payouts" compared with big banks over the years, said Robert McCormick, chief policy officer of Glass, Lewis & Co., a shareholder adviser.

Franklin Resources, which operates Franklin Templeton Investments, said in a securities filing that Chief Executive Gregory E. Johnson had total compensation of $9.9 million in the fiscal year ended Sept. 30, up 47% from 2010.

Mr. Johnson's incentive bonus was unchanged at $2.65 million, but his stock-based award jumped to $6.35 million from $2.6 million. Holly Gibson Brady, a spokeswoman for Franklin Resources, said fiscal 2011 was a "very strong year." Franklin's profit rose 33%.

At Federated, of Pittsburgh, President and CEO J. Christopher Donahue had total compensation of $4.6 million in 2011, up 28% from 2010, according to a securities filing. The biggest jolt came from a $1.9 million stock award, up 64% from a year earlier. Federated's net income fell 16% to $151 million, largely because of fee changes to its money-market funds, but the company set his pay based on an operating-profit target of $65 million. Federated had an operating profit of $176 million.

Francine McKenzie, a managing director at Johnson Associates, said it is common for companies to set bonus targets based on operating profit.

In contrast, Goldman Sachs Group Inc. Chairman and Chief Executive Lloyd C. Blankfein's stock bonus was cut for the first time since the financial crisis. His cash bonus hasn't been disclosed yet.

Goldman has said Mr. Blankfein would make $2 million in salary for 2011, up from $600,000 for 2010.

At Morgan Stanley, total compensation for Chief Executive James Gorman fell by about 25% last year, according to the company. Exact figures haven't been disclosed.

Securities firms are facing potential regulatory curbs such as the Volcker rule, which would limit proprietary trading. At asset managers, the biggest regulatory threat is a Securities and Exchange Commission plan to tighten rules on money-market mutual funds.

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THE WALL STREET JOURNAL.
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Global Finance: Ohio Jettisons 2 Trust Banks

By Matthias Rieker and Jean Eaglesham
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20 March 2012
The Wall Street Journal
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C3
English

Four Ohio pension funds severed ties with Bank of New York Mellon Corp. and State Street Corp. amid government investigations into whether the banks overcharged clients for currency trading.

Ohio's state treasurer chose J.P. Morgan Chase & Co. and Citigroup Inc. to replace the trust banks. In a statement, the state treasurer, Josh Mandel, said he wanted to protect Ohio pension funds from alleged fraud the state cited in a recent lawsuit against BNY Mellon.

Last week, Ohio Attorney General Mike DeWine filed a civil suit against BNY Mellon seeking $16 million in damages, alleging fraud, deceptive practices and breach of contract when it conducted foreign-currency trades.

A spokesman for BNY Mellon said: "We're disappointed by the treasurer's actions. As we have stated previously, the suit by the Ohio attorney general recycles baseless allegations and we are confident we are right on the facts and the law."

In a statement, State Street said Ohio "remains a valuable client," adding that "we will not otherwise comment on our relationship with the State." The bank said it offers "clients and their investment managers a range of" options in handling currency trading.

The Ohio move is the first time a state publicly completely has severed ties with BNY Mellon amid the currency-trading investigations; previously, pension funds in Massachusetts and Los Angeles have restricted foreign-exchange trading with the bank.

Last year, the attorneys general of several states, including Virginia and Florida, sued BNY Mellon for damages and civil penalties over its currency trading. In October, Massachusetts's securities regulator alleged that the bank defrauded a state pension fund. The bank has denied the allegations.

In January, the bank agreed to a partial civil settlement with the Justice Department that forces the custodial bank to change some disclosures about its foreign-exchange services. The bank didn't admit or deny wrongdoing as part of the pact.

The California attorney general previously sued State Street, alleging that it overcharged a state pension fund. State Street has disclosed that federal authorities are investigating the currency-trading activities of the bank. State Street has said it hasn't engaged in wrongdoing. The investigations are examining whether State Street overcharged clients.

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THE WALL STREET JOURNAL.

Markets
Ohio Jettisons 2 Trust Banks

By Matthias Rieker And Jean Eaglesham
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The Wall Street Journal Online
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English

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"The pattern of fraud that has been detailed and alleged across the country against banks…is an extreme breach of the public trust," said Mr. Mandel, the Ohio treasurer. Mr. DeWine's legal allegations "reinforced my decision to designate new international custodians for Ohio pension funds to safeguard retiree and taxpayer dollars," Mr. Mandel said in the statement.

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THE WALL STREET JOURNAL.

Markets

Exchange-Traded Funds; ETF Choices for Income Investors; Advisers take varied routes in combining funds for people who don't want lots of risk

By Ari I. Weinberg
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The Wall Street Journal Online
WSJO
English

Income-oriented investors are caught between a rock and a hard place. On the one side, the Federal Reserve is keeping Treasury bond yields artificially low. On the other, dividend stocks offer tempting payouts but with painful ups and downs in price.

What to do?

We asked four advisory firms that build portfolios of exchange-traded funds for their picks for a traditional income-oriented investor. Three companies suggested portfolios heavy on bond funds—no surprise—but with some significant differences in their allocations to certain fixed-income sectors.

A fourth offered a more aggressive and volatile portfolio that is about 40% in bonds. (We asked each to pick no more than eight ETFs.)

One of the simplest ways to get bond exposure through ETFs is to buy a single fund indexed to the Barclays Capital U.S. Aggregate Bond Index—a broad index of investment-grade bonds that includes Treasurys and other U.S. government debt, high-quality corporate bonds and mortgage-backed securities. BlackRock Inc's iShares unit, State Street Corp. and Vanguard Group all offer such ETFs.

Picking a mix of ETFs, by contrast, can enable investors or advisers to include noninvestment-grade or international debt, take a more tactical approach in moving among sectors, or fine-tune risk levels.

"It's as much about income as it is about risk control," says Brendan Clark, executive vice president of Clark Capital Management Group Inc. in Philadelphia.

Here's a closer look at the portfolios suggested by Clark Capital and the other firms:

CLARK CAPITAL MANAGEMENT GROUP. Mr. Clark's firm manages nearly $2.5 billion in assets, including $182 million in its Clark Navigator Fixed Income Total Return strategy. That strategy is currently 97% invested in high-yield corporate-bond ETFs, with the dollars split between iShares iBoxx $ High Yield Corporate Bond and SPDR Barclays Capital High Yield Bond. In January, the managers sold out of a 47% investment in intermediate Treasury bonds.

Compared with investment-grade bonds and Treasurys, the higher income from below-investment-grade bonds will provide more of a cushion if and when interest rates rise, Clark Capital believes.

The portfolio used to include emerging-markets bonds and preferred stocks, as well, but Mr. Clark says those securities have gotten ahead of themselves in price as yield-hungry investors snapped them up.

"We can't shoot for income for income's sake" without also weighing risk, Mr. Clark says.

INTEGRATED CAPITAL MANAGEMENT LLC. Michael Paciotti, chief investment officer at Integrated Capital Management in Scranton, Pa., is similarly shying away from international bonds and currency exposure with the fixed-income and cash investments in the ICM Total Return strategy. The firm, which manages more than $220 million, has set up this portfolio to yield a half percentage point more than the Barclays Aggregate index, which currently yields 2%.

That requires taking on slightly more duration risk—that is, risk of price declines if interest rates rise—and favoring corporate credit relative to government debt. Almost half the portfolio is in iShares Barclays Intermediate

Credit Bond, which holds high-quality corporate bonds and dollar-denominated foreign-government bonds with remaining maturities of less than 10 years.

To limit the hit the fund would take if rates rise, the strategy includes a 4% stake in iPath U.S. Treasury 2-year Bear ETN, an exchange-traded note that will go up in price if two-year Treasury yields rise.

COUGAR GLOBAL INVESTMENTS LP. James Breech, chief investment officer of Toronto-based Cougar Global Investments, says his firm runs its Cougar Global Mar 6 strategy—its primary one for generating income with low risk—with the aim of having very little volatility. The firm seeks to limit price drops due to market swings to 5% based on modeling ETFs and indexes against a survey of macroeconomic forecasts. "If we can't model it, we don't include it in the portfolio," says Dr. Breech, who taught at York University in Toronto.

Currently the largest position in the Cougar Global Mar 6 strategy, in which the firm manages about $250 million, is a 45% stake in iShares Barclays MBS Bond, which invests in investment-grade mortgage-backed securities from U.S. agencies. Dr. Breech says they bear no credit risk because of the government conservatorship of Fannie Mae and Freddie Mac.

The portfolio has a 15% stake in gold bullion, through SPDR Gold Shares. Gold is in the portfolio because it usually moves in the opposite direction of bond prices and should temper a price drop if interest rates rise and bond prices fall, the firm says.

The strategy currently doesn't include any stocks, but it has at some points in the past.

PARKER/HUNTER ASSET MANAGEMENT. "You have to be very careful in your search for yield," says Mark Luschini, who runs the Dynamic Income strategy at Parker/Hunter, a unit of securities firm Janney Montgomery Scott LLC. "When you pile into stocks with too much risk, that volatility drives people nuts." Still, he believes a portfolio that holds dividend-paying stocks, as well as bonds, can be attractive for income-oriented investors who are willing to take somewhat more price risk when equity valuations are attractive.

The portfolio employs a mix of ETFs and closed-end funds designed to deliver a long-term return that is two percentage points above inflation, as measured by the annual change in the consumer-price index. In a simplified model portfolio, Mr. Luschini puts 35% of the total in First Trust Morningstar Dividend Leaders Index, an ETF investing in high-dividend stocks.

There is also a 5% position in JPMorgan Alerian MLP Index ETN, an ETN that tracks an index of master limited partnerships, which are mostly operators of energy pipelines.

Mr. Weinberg is a writer in New York. Email him at reports@wsj.com.

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THE WALL STREET JOURNAL.

Markets

Mortgage-Bond Deal Draws a Fine; As Other Firms Are Targeted, State Street to Pay $5 Million to Settle Massachusetts Charges

By Jean Eaglesham
743 words
29 February 2012
The Wall Street Journal Online
WSJO
English

Massachusetts's securities regulator is conducting a wide-ranging investigation into the Wall Street mortgage-bond system that helped fuel the financial crisis.

Secretary of the Commonwealth William Galvin said his office is investigating "how banks misled buyers" in the multibillion-dollar deals.

"We're actively investigating a number of deals, a number of entities," Mr. Galvin said in an interview.

In the first enforcement action to result from the probe, the state regulator Tuesday fined State Street Corp. over its role as investment manager for a deal called Carina CDO Ltd.

Carina was a $1.56 billion collateralized debt obligation created in 2006, as Wall Street's CDO system was at its height. CDOs are deals based on pools of subprime mortgages and other loans, slices of which are sold to investors.

State Street failed to tell investors that Illinois-based hedge-fund firm Magnetar Capital LLC had helped to set up Carina, while also betting against $142 million of the underlying assets, the Massachusetts regulator said.

"The investigation established that State Street knew that Magnetar was shorting some or all of the portfolio but allowed the hedge fund to participate in meetings to discuss portfolio composition" and to recommend assets, it said.

When Carina collapsed in November 2007, with losses to investors of about $450 million, Magnetar was "able to reap a windfall" from its net short position on the deal, the regulator said. A spokesman for Magnetar declined to comment.

State Street, which agreed to pay penalties totaling $5 million to settle the civil securities fraud charges, said in a statement that it neither admitted nor denied the Massachusetts regulator's findings.

Deutsche Bank AG structured the Carina deal. Mr. Galvin said Deutsche is one of a number of firms under investigation by the Massachusetts regulator.

A spokesman for Deutsche declined to comment.

The Massachusetts enforcement action follows a blueprint already used by the Securities and Exchange Commission for a handful of civil enforcement actions over similar mortgage-bond deals.

The Massachusetts settlement reveals new details about the influence exerted by Magnetar, alleging the hedge fund helped to craft some 26 CDOs while betting against the underlying assets.

Deutsche Bank created Carina at the request of Magnetar, and involved the hedge fund in discussions with State Street about which assets to select for the deal, according to the settlement agreement.

It quotes an internal email sent by a State Street executive in June 2006 as Carina was being put together.

"It seems a large U.S. hedge fund has asked DB [Deutsche Bank] to structure a deal," the email said.

"Smells like a lay-up to me but we need to respond very quickly," the message added.

Magnetar got the chance to affect the name of the deal, which was taken from a constellation in the southern sky, according to the court filing.

It quotes a State Street email from June 2006 saying the bank had asked a Magnetar executive "if he has a preference for the name of the CDO. The owner of the firm is an astronomy buff…so [he] would like to see the deal named after a constellation."

Officials of the hedge fund attended meetings with representatives of State Street and Deutsche at State Street's Boston offices as the deal was being put together, according to the Massachusetts regulator. It quoted from an email sent by a State Street employee to a Magnetar executive in July 2006 promising to "keep you posted on my progress" on Carina.

Magnetar hasn't been accused of wrongdoing by any regulator. Its role in a number of mortgage-bond deals has been scrutinized by the SEC, according to people familiar with the matter.

The hedge fund has previously said it wasn't betting against the housing market and didn't "select" assets in the CDOs in which it invested.

The SEC is investigating whether investors in a $1.6 billion mortgage-bond deal called Delphinus CDO 2007-1, created by Mizuho Financial Group Inc., were told about Magnetar's input into the deal, The Wall Street Journal has previously reported. Mizuho said last month it had "been asked by the SEC to provide related documents and information, and it's currently dealing with it."

Write to Jean Eaglesham at jean.eaglesham@wsj.com

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THE WALL STREET JOURNAL.
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By Jean Eaglesham
740 words
29 February 2012
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Markets

Deutsche Bank, Guggenheim Discuss Asset-Management Deal

By Laura Stevens And Kirsten Grind
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English

Deutsche Bank AG moved closer to unloading the bulk of its flagging asset-management operation, entering exclusive talks to sell the businesses to Guggenheim Partners LLC.

The divisions up for sale, including the bank's U.S. money-management arm, oversee about €400 billion ($537 billion) in assets. The operation is likely to fetch between $1 billion and $2 billion, analysts and insiders say. That is less than Deutsche Bank's initial asking price of $3.4 billion, according to a person familiar with the auction.

A sale would end Deutsche Bank's decadelong effort to establish itself as a major fund manager in North America. While the asset-management business has been profitable in recent quarters, it has struggled for years to gain scale and has lagged behind much of the industry.

Guggenheim manages about $125 billion in assets. The firm has expanded rapidly, in part through acquisitions. It has bought Security Benefit Corp., a retirement plan servicer, and insurer EquiTrust Life. And in the past year, Guggenheim launched a municipal investment-banking team and a global trading platform.

"They've been very active in growing their asset-management business," said Darlene DeRemer, managing partner of Grail Partners, a boutique investment bank focused on asset managers. "This would be a transformational deal for them. It would leap frog them from being in rankings of 160 to 165 of global asset managers to the top 20."

Germany's largest bank signaled in November that it would jettison its asset-management business, launching a strategic review of RREEF, a manager of alternative investments; DB Advisors; DWS Americas and Deutsche Insurance Asset Management. The bank excluded its core DWS Investment global mutual-fund businesses in Asia and Europe, which complement its retail-banking businesses in those markets.

About a dozen buyers bid on parts of the divisions up for sale earlier this month. Macquarie Group and Guggenheim placed bids for the whole operation, according to people familiar with the matter. Other bidders included Ameriprise Financial Inc., State Street Corp. and Acquiline Holdings LLC.

The lender will provide some financing to facilitate the deal, according to people familiar with the matter. A deal may be finalized within the next few weeks.

Deutsche Bank declined to comment beyond a statement disclosing its talks with Guggenheim.

"We are pleased to enter into exclusive negotiations with Deutsche Bank and believe its asset-management businesses represent an attractive opportunity for Guggenheim to leverage our expertise," a Guggenheim spokeswoman said.

Selling the business will help Deutsche Bank boost capital at a time when many analysts estimate the lender needs between €10 billion and €20 billion to meet future regulatory capital requirements.

"It's not a particularly profitable business" for Deutsche Bank, said Jon Peace, a banking analyst with Nomura.

Deutsche Bank acquired much of its current asset-management business when it bought Bankers Trust, a U.S. investment bank, in the late 1990s. It built on those holdings with its purchase of the U.S.-based asset manager Scudder Investments in 2002.

Deutsche Bank management at the time believed those deals would help vault it to the top of the global rankings in asset management. But its lack of experience in the fiercely competitive U.S. market thwarted its progress there, analysts say.

RREEF is a group of alternative investment funds, including infrastructure, commodities and private equity, but it consists primarily of real-estate funds. With a staff of about 600 and around $63 billion in assets under management, it is one of the largest property managers in the world.

Craig Karmin contributed to this article.

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PRIVATE EQUITY

Kravis, Roberts Each Got

$94 Million Last Year

KKR & Co. co-founders Henry Kravis and George Roberts each received $94 million from compensation and their slice of the profit on its investments for 2011, according to a securities filing.

Most of each executive's total came in the form of cash dividends. Messrs. Kravis and Roberts, who started KKR in 1976 and are co-chief executives, were entitled to $64 million each in distributions from their combined 25% stake in the firm, the filing showed.

They also got payments of $29.3 million apiece from KKR's carried interest pool, plus a fixed salary of $300,000 each.

Carried interest is a share of profits from an investment fund or partnership given to managers as compensation.

For 2010, Messrs. Kravis and Roberts each got $20.1 million in compensation and $52 million in dividends. As of Dec. 31, KKR had $59 billion in assets under management. The firm has completed more than 200 private-equity investments with a combined transaction value of over $465 billion.

In January, private-equity firm Carlyle Group said its three founders together earned more than $400 million last year, reflecting their large ownership stakes in the firm. That disclosure was made as part of Carlyle's preparations for an initial public offering.

-- Amy Or

MADOFF CASE

Ex-SEC Lawyer, Brothers

To Repay Inheritance

A former top attorney for the Securities and Exchange Commission and his two brothers have agreed to pay back $556,017 they inherited that was tied to the Bernard Madoff Ponzi scheme.

The settlement, which still requires approval by a federal bankruptcy court in New York, ends a lawsuit brought in 2010 by Irving H. Picard, trustee for the liquidation of the Madoff firm. Former SEC General Counsel David Becker and his two brothers were heirs to their mother's 2004 estate, which included about $2 million that had been invested with the Madoff firm.

William Baker, an attorney for Mr. Becker, said his client, now an attorney at Cleary Gottlieb, wasn't aware of his mother's account until after it was liquidated and always expected that he would return any fictitious profits he unknowingly received.

-- Andrew Ackerman

FOREX TRADING

State Street Reports

U.S., State Investigation

U.S. and New York state prosecutors are investigating State Street Corp.'s foreign-exchange trades, the bank said, potentially putting more pressure on a major source of revenue for the company.

The New York state attorney general and the U.S. attorney for the Southern District of New York have made inquiries into what State Street described as "our indirect foreign-exchange execution methods."

Those same New York authorities last year filed civil lawsuits against Bank of New York Mellon Corp., State Street's top rival. In a lawsuit in October, the New York attorney general alleged BNY Mellon earned $2 billion over the decade from the trading.

Earlier this month, the U.S. attorney in Manhattan filed an amended complaint against BNY Mellon that said the bank "repeatedly lied" about its forex transactions. The bank has denied any wrongdoing.

Boston-based State Street, the largest provider of mutual-fund custody and accounting services in the U.S., made the disclosure about the New York investigation in its annual report with the Securities and Exchange Commission.

At issue are the prices custody banks have charged on nonnegotiated trades, typically on forex transactions less than $1 million. Pension funds and U.S. authorities have accused the custody banks of misrepresenting the pricing on the trades.

The banks have denied any wrongdoing, but they also have changed their practices.

-- Reuters

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THE WALL STREET JOURNAL.

Markets
As ETFs Multiply, Companies Scramble To Concoct Memorable Ticker Symbols

By Rachel Louise Ensign
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6 February 2012
The Wall Street Journal Online
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English

In a crowded market for exchange-traded funds, some industry heavyweights employ clever marketing to make their products stand out. BlackRock Inc.'s iShares is a Cirque du Soleil sponsor, while State Street Global Advisors uses a professional golfer known as Spiderman as a pitchman for its SPDR funds.

But for most companies, the way to make an impression is to come up with attention-grabbing ticker symbols. A symbol can stand out for being literal (SOIL, Global X Fertilizers/Potash), figurative (DUST, Direxion Daily Gold Miners Bear 3X) or just plain alluring (GGGG, Global X Pure Gold Miners).

"It's kind of like when you have vanity plates on your car," says Laura Morrison, senior vice president of global index and exchange-traded products at the New York Stock Exchange.

But finding a catchy symbol can be tough these days. Many have already been taken: 1,350 symbols are in use on the NYSE Arca alone, the biggest U.S. market for exchange-traded products. That's up 108% over the past five years, says Ms. Morrison. In addition, fund firms have reserved 2,446 symbols for future products, with about six new ones being reserved each day, she says. Then there are the tickers of bygone ETFs, whose association with failure means many firms won't use them.

When fund companies are preparing to launch a new ETF, they generally come up with a long list of potential ticker symbols that is often the product of a cross-departmental brainstorm. With many three-letter symbols used up, they're focusing on four-letter ones—and considering words only elliptically related to the actual fund.

At Direxion Funds, advised by Rafferty Asset Management LLC, that list often originates with David Fajardo, the senior vice president of marketing, who is known for his ticker-symbol prowess. When the Cambridge, Mass., company was looking to give its long and short China funds catchier tickers, Mr. Fajardo came up with YINN and YANG, inspired by a yin-yang shirt his then-12-year-old son was wearing. "It immediately spoke to the fund pair being both sides of the trade," he says.

This sort of out-of-office inspiration also led to the ticker for at least one of First Trust Portfolios' ETFs. In 2010, Kyle Baker, in charge of launching new products at the time, was stumped about what the ticker should be for a forthcoming copper ETF. His wife, Megan, who has a background in science, suggested CU, the metal's symbol in the periodic table of elements. That became the ETF's ticker—and Megan, a trainee at the firm at the time, ended up landing a job there.

Global X Management Co. of New York typically goes through about 10 to 15 possible tickers before picking one that is both available and memorable, says Justin Young, head of sales. Last year, Global X introduced VROM (Global X Auto) and BARN (Global X Farming).

But a catchy symbol can't always help a fund survive in a saturated market. Neither VROM nor BARN has attracted many investor dollars, compared with some of Global X's older ETFs with less flashy tickers. Indeed, BARN is set to shut this month.

"All things being equal, if you've got a more memorable ticker symbol, then people will be remembering you more," says Ryan Issakainen, ETF strategist at First Trust. The problem is, he says, "all things are never equal."

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THE WALL STREET JOURNAL.
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Global Finance: Trust Banks Sag; BNY Mellon Net Falls 26%

By David Benoit
451 words
19 January 2012
The Wall Street Journal
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English

Revenue at the three big U.S. trust banks came in below expectations as cautious clients and reduced trading volume in the fourth quarter weighed on their fees.

There was a sharp drop-off in foreign-exchange volumes and an increase in the amount of fees money managers had to return to clients because of slim results for the banks, which handle the funds for trusts and for Wall Street banks. Trust-bank money managers' fees are pegged to performance targets.

Bank of New York Mellon Corp., the largest so-called custody bank, said volumes slumped as clients looked at global turbulence and headed for the bunkers. The drop in foreign-exchange volumes also comes amid scrutiny over the treatment of trading clients. On Tuesday, BNY Mellon reached a partial settlement with the Justice Department that would change how it describes forex offers to clients.

State Street Corp. and Northern Trust Corp. also missed revenue forecasts, sending shares falling. BNY Mellon declined 4.6% to $20.30 in 4p.m. trading. State Street sank 6.6% to $39.95 and Northern Trust fell 1.7% to $41.22.

"As the year end approached, we saw a complete" risk-averse environment, BNY Mellon Chief Executive Gerald Hassell said on a conference call. "We do think that that is short-lived. Investors do have to invest, they do have to get a return, but I think we just saw a very soft fourth quarter."

BNY Mellon's profit dropped 26% to $505 million, or 42 cents a share. Restructuring charges tied to the bank's efforts to cut costs reduced earnings by six cents a share. Analysts polled by Thomson Reuters expected earnings of 53 cents a share.

Revenue fell 5.6% to $3.54 billion, below the $3.75 billion analysts expected. Fee revenue was down 6.8%. Fees also were down 4% from the previous quarter, when BNY Mellon had said it gained business as clients increased outsourcing.

Foreign-exchange revenue dropped 11% from a year earlier, while investment-management and performance fees fell 9%.

At State Street, profit surged as the prior year was slammed with charges. The Boston bank reported earnings of $381 million, or 76 cents a share, compared with 16 cents a share a year earlier. Excluding restructuring charges and other moves, earnings would have climbed to 93 cents from 87 cents.

Profit at Chicago's Northern Trust fell 17% to $130.2 million, or 53 cents a share, which includes restructuring and other one-time items that reduced the figure by a net 14 cents.

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THE WALL STREET JOURNAL.

Markets
Trust Banks Sag; BNY Mellon Net Falls 26%

By David Benoit
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Revenue at the three big U.S. trust banks came in below expectations as cautious clients and reduced trading volume in the fourth quarter weighed on their fees.

There was a sharp dropoff in foreign-exchange volumes and an increase in the amount of fees money managers had to return to clients because of slim results for the banks, which handle the funds for trusts and for Wall Street banks. Trust-bank money managers' fees are pegged to performance targets.

Bank of New York Mellon Corp., the largest so-called custody bank, said volumes slumped as clients looked at global turbulence and headed for the bunkers. The steep drop in foreign-exchange volumes also comes amid scrutiny over the treatment of trading clients. On Tuesday, BNY Mellon reached a partial settlement with the Justice Department that would change how it describes forex offers to clients.

State Street Corp. and Northern Trust Corp. also missed revenue forecasts, sending shares falling. BNY Mellon was down 4.8% to $20.24 in mid-afternoon trading, while State Street sank 6.4% to $39.99 and Northern Trust fell 1.9% to $41.13.

"As the year end approached, we saw a complete" risk-averse environment, BNY Mellon Chief Executive Gerald Hassell said on a conference call. "We do think that that is short-lived. Investors do have to invest, they do have to get a return, but I think we just saw a very soft fourth quarter."

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Foreign-exchange revenue dropped 11% from a year earlier, while investment-management and performance fees fell 9%.

Chief Financial Officer Todd Gibbons said in an interview that the dramatic decline in activity could be seen in the dropoff in stock trading, and hasn't turned around in the new year. But he said the bank is adding clients.

"We are pretty darn optimistic about that," Mr. Gibbons said.

BNY Mellon's assets under management and under custody grew, and deposits were again soaring. Total deposits, at $219.1 billion, are now up more than 50% from a year earlier.

BNY Mellon faces lawsuits from pension funds, the state of New York and the Justice Department over how it handles forex trades for clients. The suits have focused on an offering known as "standing instruction," whereby the bank conducts foreign exchange trades for clients. The crux of the suits allege that offering leaves clients with the worst exchange rate of the day, no matter what rate the trade was made at. State Street has faced similar claims.

BNY Mellon has adamantly denied the allegations. On Tuesday it agreed to a partial settlement with the U.S. attorney in Manhattan to not call the program "free" or "best execution" and to increase disclosures.

Some analysts have been concerned that the profitability of forex, which has surged as a revenue center for custody banks, would be hurt by lawsuits.

Mr. Gibbons said more clients are negotiating their rates, partly because of the attention, but he called the shift inevitable and said it didn't hurt margins this quarter. The bank hopes to make up for the shift with more volume.

At State Street, profit surged as the prior year was slammed with charges. The Boston bank reported earnings of $381 million, or 76 cents a share, compared with 16 cents a share a year earlier. Excluding restructuring charges and other moves, earnings would have climbed to 93 cents from 87 cents, just shy of the 94 cents analysts expected.

Revenue, on an operating basis, was flat at $2.29 billion, below the $2.4 billion Wall Street expected, as fee revenue dropped 4%.

Foreign-exchange revenue declined 12%. State Street Chief Financial Officer Edward Resch also said indirect forex products have declined.

For Chicago-based Northern Trust, profit fell 17% to $130.2 million, or 53 cents a share, which includes several restructuring and other one-time items that reduced the figure by a net 14 cents. Analysts had expected 68 cents a share in earnings.

Revenue rose 6.6% to $955.6 million, but fell short of the $970 million analysts expected.

Erin McCarthy contributed to this article.

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THE WALL STREET JOURNAL.

Today's Markets
Markets
Dow Finishes Up 96 Points

By Jonathan Cheng
706 words
18 January 2012
04:24 PM
The Wall Street Journal Online
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English

Stocks rose to multimonth highs and the Standard & Poor's 500-stock index finished above 1300 for the first time since July as home-builder sentiment hit its highest level since 2007.

The Dow Jones Industrial Average gained 96.88 points, or 0.8%, to 12578.95, chalking up its biggest one-day gain in more than two weeks. The S&P 500 rose 14.37 points, or 1.1%, to 1308.04, for its sixth gain in seven days. The Nasdaq Composite surged 41.63 points, or 1.5%, to 2769.71, bringing its gains this year to 6.3%.

"We're back to where we were in July, and that should remind investors that markets are resilient and, despite the challenges, companies and policy makers are able to do what they need to do in order to move forward," said Kate Warne, investment strategist at Edward Jones.

Financial stocks led Wednesday's advance, helped by encouraging news at Goldman Sachs Group and the strong housing data. Bank of America climbed 4.9% and J.P. Morgan Chase rose 4.7% to lead the Dow components.

Technology stocks were also strong on a day that saw just one sector of the S&P 500, utilities stocks, finish lower.

The gains were propelled by a report from the National Association of Home Builders, which showed confidence among home builders in January rising to a stronger-than-expected reading of 25. That level, while far short of the reading of 50 that indicates positive sentiment, was the highest since June 2007, pushing shares in home builders higher. Hovnanian Enterprises shot up 12%, KB Home gained 7.6% and Beazer Homes USA rose 6.4%.

European markets were little changed after the International Monetary Fund identified a need for $600 billion in additional resources to help fight the European debt crisis. Germany sold two-year notes at the lowest yield on record and Portugal sold the maximum targeted amount of government debt. Damping some of this optimism, Germany cut its 2012 economic growth forecast to 0.7% from 1%.

The Stoxx Europe 600 finished up 0.1% after falling as much as 0.9%. France's CAC-40 index finished with a small loss.

Gold rose 0.3% to settle at $1,659.50 a troy ounce. The yield on the 10-year Treasury rose to 1.897%.

In U.S. economic news, U.S. wholesale prices fell 0.1% in December, though the underlying rate, which excludes food and energy costs, rose a higher-than-expected 0.3%. Industrial production increased 0.4% in December, while capacity utilization came in at 78.1%; both numbers were roughly in line with expectations.

In corporate news, Goldman Sachs Group tacked on 6.8% after earnings and revenue slumped, though the Wall Street bank's profits topped lowered expectations.

Yahoo rose 3.2% after the company said co-founder Jerry Yang has resigned from the board, as well as from the boards of Yahoo Japan and Alibaba Group Holding.

Bank of New York Mellon fell 4.6% after the trust bank reported fourth-quarter earnings and revenue that missed estimates, saying general uncertainty in the financial markets led to lower levels of client activity. State Street slumped 6.6% to lead the S&P 500 decliners after the trust bank's revenue from fees weakened.

Linear Technology climbed 12% to top the list of S&P 500 advancers after the semiconductor maker reported fiscal second-quarter earnings that exceeded expectations.

Majesco Entertainment tumbled 27% after the videogame maker reported a fourth-quarter loss, while analysts had been expecting a profit, and provided a 2012 earnings outlook that was below expectations.

Cree, a maker of LED lighting, rose 4.8% after the company reported fiscal second-quarter earnings and revenue that fell shy of expectations.

Research In Motion fell 1.1%, erasing some of the stock's 8% run-up on Tuesday, after Samsung Electronics denied rumors that the BlackBerry maker is considering selling all or part of it to the Korean electronics company.

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Markets
BNY Mellon Deal Details Changes on Currency Disclosures

By Michael Rothfeld And Jean Eaglesham
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17 January 2012
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English

A partial settlement of a civil suit between Bank of New York Mellon Corp. and federal prosecutors provides new details of how the bank has agreed to change disclosures on its pricing for currency trades.

In the deal, the bank agreed within 30 days to stop representing that "standing-instruction" trades—ones made automatically as needed for institutional clients—are free, or that they are subject to "best execution," or the best possible price.

The deal addresses a request by Manhattan U.S. Attorney Preet Bharara—who accused the bank in the civil suit in October of overcharging some clients for currency trades—for a court order requiring full disclosure of pricing for those trades. U.S. District Judge Lewis A. Kaplan approved the partial settlement Tuesday. The U.S. attorney's office had no comment on the settlement.

The bank has denied wrongdoing and is fighting demands for damages of hundreds of millions of dollars by federal prosecutors, along with state-government suits seeking more than $2 billion based on similar allegations.

The state suits, some of them fueled by whistleblower claims, relate to currency trading the bank did on behalf of clients including state and public pension funds. As a custody bank for those clients, BNY Mellon exchanged currency to facilitate investments made in foreign countries. The federal and state lawsuits accuse BNY Mellon of telling clients the currency trades were free of any bank fees, when in fact the bank made money on the spread between the prices at which trades were made and the prices charged to clients.

A bank spokesman said Tuesday that BNY Mellon is "confident that we have provided our clients and their investment managers with the information they need to make informed trading decisions." But he added that the agreement "addresses disclosure questions raised by the U.S. Attorney and is consistent with our ongoing commitment to implement enhancements that will benefit our clients."

Prosecutors referred to the settlement in a court filing last week but didn't provide details. The deal requires BNY Mellon to publish average purchase rates for currencies on a secure website for clients every 90 days; to disclose how it determines pricing for standing-instruction transactions; and to post a link to Tuesday's agreement on its website for a year, among other changes.

The Wall Street Journal reported last year that a whistleblower alerted state government officials to changes Bank of New York Mellon made in its description of the standing-instruction service after news broke of an October 2009 lawsuit against rival State Street Corp. with similar allegations.

Those changes included removing the phrase "free of charge" from the description of the standing-instruction service on the bank's website by November 2009, according to copies of documents submitted by the whistleblower's lawyers. BNY Mellon said in court filings that it routinely updates its marketing materials and the "free of charge" language referred to the fact there was no transaction fee for the currency trades.

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Markets

Crisis Causes Shift in Use of Bond Indexes; European Benchmarks Carry Heavy Weightings of Troubled Debt

By Tom Lauricella
1,213 words
17 January 2012
The Wall Street Journal Online
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English

Credit downgrades last week of France, Austria and other European countries throw a spotlight on a dilemma investors have been wrestling with for months: how best to build a safe portfolio of European government bonds.

Big investors such as pension funds and insurance companies are increasingly looking for alternatives to widely used indexes that have long been the road map for how most institutional portfolios are constructed.

"Investors are beginning to question, quite rightly, the integrity of some of the sovereign issuers in the composition of European and the global benchmarks," says Bill Street, a senior managing director for global fixed income at State Street Global Advisors in London.

This shift has important implications beyond the world of index developers and pension funds. These kinds of changes in how pension funds and other large, long-term investors such as insurance companies invest means a shrinking of the investor base for countries such as Italy and Spain at a time when they desperately need to tap bond markets. And this kind of trend isn't one that is likely to be quickly reversed. Pension funds, in particular, tend to move slowly when it comes to such fundamental aspects of their investment strategies.

The weightings of debt from different countries within these benchmarks provide the starting point for how institutional investors allocate their money as well as a guidepost against which they measure their performance.

But for investors in European government bonds, sticking with established indexes—such as those typically created by banks like Barclays and J.P. Morgan Chase—would mean continuing to funnel money designated for safe investments into debt from countries that have turned out to be more volatile and much riskier than had been thought.

That includes countries that have been shut out of the bond market, such as Portugal. And it would mean having upward of one-fifth of their portfolios in Italy despite its entrenched fiscal and economic woes. Now even France and Austria, which saw their credit ratings cut from the top level of triple-A to double-A-plus by Standard & Poor's on Friday, are deemed less safe.

With traditional bond-market benchmarks, allocations are linked mainly to the size of a country's bond market. The effect of those benchmarks is to plow more money into the most heavily indebted nations.

Italy, which has the third-largest bond market in the world, is often around 20% of European government-bond benchmarks. In contrast, the Netherlands, which has a triple-A rating but a smaller bond market, is often around 6% of benchmarks.

As a result, some big investors have been restructuring their bond portfolios based on benchmarks consisting only of bonds issued by countries with the highest credit ratings. Or else they are looking to benchmarks where allocations are based on the relative size of countries' economies, the thinking being that larger economies can support more debt.

For its European government-bond holdings, Syntrus Achmea, a money manager that runs pension funds in the Netherlands, has switched to a benchmark with a greater emphasis on gross domestic product.

"We're deliberately putting more weight on the safest" countries, says Wim Barentsen, chief strategist at Syntrus Achmea, which oversees €52 billion ($66 billion).

The downside to these new strategies, however, is that it can leave pension funds with their portfolios more concentrated in a smaller number of countries, theoretically exposing them to greater risk should one of those bets go wrong. And some of the countries with the strongest fiscal outlooks, such as Norway, have small bond markets that make it difficult for big investors to take meaningful positions.

Index firms take varying approaches to how they construct benchmarks for European government-bond portfolios.

But according to money managers and industry data, it is common for indexes to call for investors to hold more than 20% of a portfolio in bonds issued by Italy. Spain is often more than 10% of European sovereign-debt indexes, while Ireland and Portugal often make up about 2% each. Belgium, which has been suffering from political instability and debt worries, will often clock in at around 5% or 6% of a benchmark.

France is generally more than 20% of benchmarks. Germany, which is seen as a safe haven by many investors, is usually another 20% to 25% or so of an index. A smattering of other countries will make up the rest.

Overall performance of the benchmarks hasn't necessarily been the issue. The Barclays Capital Euro Treasury Bond Index is up roughly 3.9% over the past year, as gains in stronger countries' bonds have offset losses on some weaker countries. The concern, rather, is about holding individual securities that are more risky and volatile.

While money managers say this trend has been building across Europe, they say it is most evident among northern European institutional investors, such as those in Germany, Sweden and the Netherlands. One reason is that the "home bias" for pension funds in places such as Spain or Italy may make it politically difficult to severely cut holdings of their own country's debt, analysts say.

European institutional investors had counted on their sovereign-debt holdings to be safe, liquid and low in volatility. The bond holdings were supposed to diversify broader portfolios against losses in riskier investments.

But at a time when European stocks have been clobbered, many of these countries' bonds have lost value.

"Instead of being a safe haven in times of deflation risk and financial crisis, they have performed adversely," says Syntrus Achmea's Mr. Barentsen. Syntrus Achmea now has 75% of its government-bond portfolio in debt from Germany, France and the Netherlands, he says.

"This part of the portfolio is not supposed to be risky," says Kommer van Trigt, head of the interest-rates team at Rotterdam-based Robeco, which manages money for pension funds and insurers. "We have seen clients starting to exclude certain countries…and quite a big group has moved to triple-A-rated debt only," Mr. van Trigt says.

For accounts in which Robeco has discretion, its portfolios are more than 60% in debt issued by Germany and the Netherlands. Those portfolios aren't holding debt from Greece, Portugal, Ireland, Italy and France, Mr. Van Trigt says.

At Swedish pension fund AP2, with $33.5 billion in assets, officials have been discussing turning away from market-weighted indexes, says head of fixed income Ole Petter Langeland.

While they haven't made any large strategic changes yet, they have been crunching the numbers on different index constructions.

"I would expect that it would be the next step for us to move away from benchmarks that are purely based on the size of the debt issued," Mr. Langeland says.

An important variable for any new benchmark would likely be financial strength, he says.

"Traditionally you look at a government-bond portfolio as something that's going to give you rather small, but steady income," Mr. Langeland says. "It's not tolerated to lose a lot of money in those investments."

Matt Phillips contributed to this article.

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THE WALL STREET JOURNAL.

Personal Finance
Fidelity Investments Looks Ready To Offer Exchange-Traded Funds

By Ari I. Weinberg
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After years of ignoring one of the hottest investment options, Fidelity Investments appears to be planning a push into exchange-traded funds.

The fund giant recently filed an application with the Securities and Exchange Commission to offer a broad swath of index-based exchange-traded funds. The filing, if approved, would allow Fidelity to offer almost every type of index ETF available, including international funds and even "long/short" ETFs that mimic sophisticated hedge-fund strategies, said Kathleen Moriarty, an ETF specialist and partner at law firm Katten Muchin Rosenmann LLP.

"It's an extensive filing," said Christian Magoon, an ETF consultant and CEO of Magoon Capital, an investment firm. "It shows that they are taking a longer-term view and want to be in this business."

A Fidelity spokesman declined to provide more details on the firm's ETF strategy, saying only that it's "always looking for new ways to provide clients with products and services they need and want."

If the company moves forward, it would be jumping into a space that has become hugely popular. ETFs track baskets of securities like mutual funds but trade like stocks, and a growing number of financial advisers are building portfolios using ETFs alongside or instead of traditional index funds.

Investors would be able to buy the ETFs through their brokerage accounts and even 401(k) plans or IRAs, regardless of their affiliation with Fidelity.

To compete with established players, analysts say Fidelity would likely offer lower-cost ETFs and index funds. But investors in Fidelity-administered 401(k) plans may see little change in costs, given that most already have access to cheap institutional-class funds with expense ratios often lower than the cheapest ETFs. A large new entrant into the ETF business, however, could potentially help drive costs down across the board.

That said, analysts point out that Fidelity is entering the ETF game both late and at a time when some say there are already too many options for investors. From January through the fall, the ETF industry unveiled 287 new funds—a rate of nearly one a day. And yet, of the more than 1,400 exchange-traded products in the U.S., 80% of the assets are controlled by about 100 funds, according to IndexUniverse, a research firm.

Currently, the U.S. ETF business is dominated by three big players—BlackRock Inc.'s iShares unit, State Street Corp.'s State Street Global Advisors and Vanguard Group Inc., which together manage 82% of the more than $1 trillion in U.S.-listed exchange-traded assets at the end of the third quarter, according to the BlackRock Investment Institute.

A big part of ETFs' appeal for regular investors is their low fees, financial advisers say. The average annual expense ratio for an actively managed large-cap stock mutual fund is 1.28%, compared with 0.71% for a large-cap stock index fund and just 0.33% for a large-cap index ETF, according to Morningstar.

Fidelity has made few inroads into the ETF business thus far. Known primarily for actively managed mutual funds, the company in 2003 launched the ONEQ ETF to compete against PowerShares's QQQ, which tracks the Nasdaq-100 Index. But it was no contest, analysts say: PowerShares' product holds $24.8 billion in assets, compared with just $149 million for Fidelity's offering, according to fund researcher Morningstar Inc.

But Fidelity's filing would allow it to follow a path similar to Charles Schwab Co.'s, say analysts, since both firms have large retail and adviser brokerage platforms. Schwab in November 2009 launched its ETF effort by waiving trading commissions on the first offerings from its family of in-house ETFs, which now total 15. Schwab has since gained nearly $5 billion in assets.

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Markets
The 2012 Regulatory and Market Landscape

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'Volcker Rule'

Boon or Bane? It Depends Which Side of Street You're On

Depending on whom you ask, the so-called Volcker rule will mean either the end of banking as we know it or toothlessly allow banks to continue to bet the house—with the backing of the U.S. taxpayer. Neither of these extremes are true, of course.

The Volcker rule, part of the landmark 2010 Dodd-Frank financial-overhaul law, will curtail large banks' proprietary-trading activities. In other words, no more multibillion-dollar bets on whether the housing market will rise or fall or whether the dollar is going to do better (or worse) than the euro or yen.

The Volcker rule isn't scheduled to be implemented until this July, but it has already had a significant impact on Wall Street. Large banks such as Goldman Sachs Group Inc. and Morgan Stanley have trimmed their proprietary-trading operations. Big U.S. banks could see their annual revenue trimmed to the tune of $2 billion a year because of the Volcker rule, according to analyst estimates.

While the rule could make banks less profitable, supporters argue it will make them less prone to economy-wrecking blowups. And over the long run, bank profits should be more stable.

There are sure to be plenty of unintended consequences of the rule, both good and bad. Bernstein Research analyst Brad Hintz says the Volcker rule could give a leg up to big banks' competitors. "The spirit of Volcker attempts to limit outsize risk-taking by individual firms, but may effectively narrow the gap between the Street's best traders and peers," he wrote in a report.

Critics worry that if the rule is too harsh, it will prevent banks from conducting plain-vanilla market-making operations—the buying and selling of assets on behalf of customers—because those activities often look like proprietary trades. That will make it tougher for ordinary investors and companies to buy and sell securities, they say.

Many questions remain about what the final version of the rule will look like. The latest proposal, at more than 300 pages, showed that regulators drafting it are grappling with a number of issues—including the definition of proprietary trading. If Republicans take control of the federal government after the 2012 election, the rule itself could be at risk. A number of congressional Republicans have vowed to scrap the Dodd-Frank law, which they say imposes too many restrictions on the financial industry.

Four regulators have already weighed in on the rule. The fifth, the Commodity Futures Trading Commission, is expected to vote on a proposal in January.

Scott Patterson

'Systemically Important'

Designation Decisions Expected on Threats to Financial System

The minute the Dodd-Frank financial overhaul became law in 2010, one of the hottest parlor games in financial circles became guessing which financial companies would get dragged into the tough, new regulatory system designed for "systemically important" firms.

The designation is reserved for financial firms that regulators believe could threaten financial stability if they run into trouble. The tougher rules include stricter capital, liquidity and leverage requirements than other firms face. While Dodd-Frank automatically puts any bank with at least $50 billion in assets in that camp, it left it up to regulators to decide which, if any, insurers, hedge funds, asset managers or other financial firms that aren't organized as banks qualify for stricter regulation and supervision by the Federal Reserve.

The Financial Stability Oversight Council, a group of the nation's top regulators, has made progress on that question and is likely to make its first designations in the coming year. But some analysts believe regulators won't name firms until late in the year given the controversy surrounding the issue.

The council in October put out a proposed three-stage process and set of criteria—including quantitative thresholds such as asset size and leverage ratio—that will guide its decision making, though regulators retain the ability to designate firms that don't fit within the guidelines. The council plans to issue a final version before it makes any designations. The period for public comment, which ended in December, gave companies and industry groups another change to deluge the council with letters arguing why they're not a threat to financial stability.

Analysts widely expect that General Electric Co. unit GE Capital and insurers Prudential Financial Inc. and MetLife Inc. will be labeled systemic; the latter are the two largest U.S. life insurers by assets. American International Group Inc. is also seen as a likely pick because it was the recipient of one of the biggest federal bailouts of the 2008 financial crisis after losses in a financial-products unit almost caused the company to collapse. Some observers say asset managers like BlackRock Inc. also will be tagged.

Meanwhile, big banks are busy writing their so-called living wills, roadmaps they must give to U.S. regulators showing how to liquidate the company if they fail. A number of the largest bank holding companies—those with at least $250 billion in U.S. nonbank assets—must submit their initial plans to the Fed and the Federal Deposit Insurance Corp. by July 1, 2012. Smaller U.S. firms have an additional year or more to draft theirs. Foreign banks have to participate, too, though those with only a small U.S. presence can write less detailed wills. Any nonbank institutions that are designated as systemically important would also have to draft a living will.

Victoria McGrane

CFTC

Over-the-Counter Derivatives, MF Global Fallout Top Agenda

The Commodity Futures Trading Commission will continue construction of a new regulatory regime for over-the-counter derivatives in 2012, while also grappling with the fallout from the failure of broker-dealer MF Global Holdings Ltd.

Regulators will continue their investigation into why an estimated $1.2 billion in customer funds went missing before the firm filed for bankruptcy protection Oct. 31 and consider the implications for the mostly self-regulated futures industry. Some traders, lawmakers and regulators have called for major changes, including the creation of an insurance fund that would help investors if their money is stolen by a broker.

The CFTC hasn't yet taken up the idea, which some worry could make trading more expensive, but it has the support of at least one commissioner, Democrat Bart Chilton, who says it is necessary to instill "confidence and trust back into our U.S. derivatives markets."

"The MF Global debacle has highlighted some significant problems with how we treat and deal with customer monies," Mr. Chilton said in a December letter to lawmakers.

While the hunt for the missing MF money continues, the CFTC will also be working on expanding its scope beyond commodities and futures to include the "swaps" market, a previously unregulated corner of the financial markets that played a role in the 2008 financial crisis. The commission is writing new rules to complete the financial-regulatory overhaul Congress put in motion with the Dodd-Frank law in July 2010.

The law instructed regulators to create a new system of oversight for swaps, which are currently traded over the counter rather than on an exchange, aimed at making the market safer and more transparent. Once finished, the CFTC's new rules will require traders to buy and sell many types of swaps on trading platforms and then route them through clearinghouses that collect money from both sides of the deal and secure the trade if one side defaults.

CFTC Chairman Gary Gensler says his goal is to finish the rules by year's end.

Jamila Trindle

SEC

Tighter Money-Fund Rules Divide Agency's Commissioners

When Lehman Brothers collapsed in September 2008, its bankruptcy triggered losses in a money-market fund called the Reserve Fund, sparking a panic in the $2.7 trillion money-market industry.

Three years later, Securities and Exchange Commission Chairman Mary Schapiro remains concerned the money-fund industry is still vulnerable to customer runs in times of panic, despite sweeping changes in 2010 designed to make the industry more resilient. The overhauls included tighter credit-quality standards and a new requirement that funds keep enough cash on hand to meet "reasonably foreseeable redemption requests"—changes designed to prevent funds from "breaking the buck," or having their price per share drop below $1.

In early 2012, Ms. Schapiro plans to push for additional overhauls that could change the way the industry functions and further reduce already-low returns for shareholders, possibly by requiring the funds to hold bank-like capital buffers to pay investors in a crisis. She says the buffers are needed to fix structural deficiencies that make funds vulnerable to runs if a security has a substantial and unexpected decline in value, which could happen if a fund owns the debt of an entity that collapses.

Such a run in 2008 caused the U.S. to step in with an unprecedented money-fund guarantee, Ms. Schapiro said in a recent statement, adding that is why she hopes to present a proposal to the commission "early in the new year" to address remaining "structural weaknesses."

To be sure, Ms. Schapiro faces an uphill battle. The money-fund industry and most of her fellow commissioners don't believe additional overhauls are needed, arguing the 2010 changes ought to be given more time to work. "I don't think I've seen the justification for further changes," Luis Aguilar, a Democrat who often votes with Ms. Schapiro, said in an interview.

Daniel Gallagher, a new Republican member of the SEC, said in a December speech that a buffer large enough to backstop funds would drain too much capital and kill the industry while a smaller buffer, even one that grows slowly over time, would only create the illusion of safety where none exists.

Mr. Aguilar said he agrees with Mr. Gallagher, and is concerned the capital-buffer idea that Ms. Schapiro has outlined would hamper "small to midsize companies that rely on money funds to meet their payroll, without adding to investor protection."

But Ms. Schapiro and other SEC staffers remain concerned about the risks to the financial system posed by money funds and don't want to wait for another panic to act. "Those who forget the past are doomed to relive it," said one SEC staffer working on the project.

Also on tap for 2012: a legal showdown over stock language in the SEC's settlements with financial firms that allows them to neither admit nor deny the agency's findings of wrongdoing. The SEC argues it is unwise to reject proposed settlements simply because a company refuses to admit guilt. But a federal district court judge, Jed Rakoff, believes firms often view settlements of serious allegations for modest penalties, and no admission of wrongdoing, as just a "cost of doing business." An appellate panel will review the ruling in January.

Andrew Ackerman

CFPB

Consumer Watchdog Fights to Claim Its Intended Bite

The six-month-old Consumer Financial Protection Bureau heads into the new year without a leader and its future makeup very much up in the air. The bureau remains particularly contentious among congressional Republicans, who are urging the White House to overhaul the agency's structure.

But partisan battles in Washington haven't stopped the watchdog from building up its market-research unit, evaluating consumers' credit-card gripes, examining the inner workings of some of the nation's largest banks and laying the groundwork for new consumer-protection rules. And even if the feud keeps it directorless, the agency in 2012 is expected to beef up scrutiny of a crucial consumer-finance product: home loans.

The consumer bureau, a centerpiece of the 2010 Dodd-Frank financial law, has already taken several steps to evaluate home-lending practices more closely. In December, it started addressing and receiving consumers' mortgage-related complaints, a function that could help alert the agency to any potential lending problems or wrongful foreclosures at a time when banks continue to face probes into fraudulent foreclosure practices.

In addition, the bureau—which has the task of ensuring that financial firms adhere to fair-lending and other consumer-protection rules—intends to keep an eye on the mortgage industry through its new supervision program, launched in July. The bureau in October made clear that its examiners would be closely evaluating banks' efforts to help troubled borrowers avoid foreclosure.

"Mortgage servicing has a huge impact on consumers and is a priority for the CFPB," the bureau's temporary leader, Raj Date, said in October, when the bureau outlined its strategy for examining mortgage companies' lending practices. "We are going to take a close and measured look at whether servicers are following the law."

The agency also will continue work on a series of projects designed to help consumers understand the costs and risk of mortgages, student loans and other products. The goal is to streamline the disclosures firms give to consumers in a way that cuts down on fine print and legalese. The bureau will also be conducting research on private student loans, as required by the Dodd-Frank law.

Meanwhile, if the bureau gets its first chief, its focus could quickly shift to payday lenders and thousands of other nonbank companies that offer consumer loans. Overseeing these lenders was supposed to be one of the bureau's most important duties. But under Dodd-Frank, the agency can't supervise nonbank firms until it has a permanent director in place.

While President Obama in July nominated ex-Ohio Attorney General Richard Cordray to serve as the bureau's director, a battle over the nomination has shown no signs of letting up. In December, Senate Republicans, who want the bureau run by a panel instead of a single director, blocked a vote on the nomination.

Maya Jackson Randall

Mortgage Rules

Regulators Aim to Avoid Repeat of Housing-Market Collapse

Regulators plan to finish two rules next year that aim to prevent a repeat of the dramatic slide in mortgage-lending standards that fed the housing bust and financial crisis.

The Dodd-Frank law mandated that lenders determine that borrowers have the ability to repay the loans they receive. And it charged regulators with creating a basic set of lending standards that the mortgage industry must follow.

Since lenders are unlikely to make loans that don't meet this ability-to-repay requirement, this first rule could effectively ban lending practices such as interest-only mortgages and loans in which the principal balance can rise.

The new Consumer Financial Protection Bureau is aiming to finish the rule early in the year, working off a proposal drafted by the Federal Reserve in the spring.

Banking groups are pressing for a broad definition of what kind of loans meet this "qualified mortgage" standard and are seeking protections against lawsuits for loans that meet the criteria set out by regulators.

Consumer advocacy groups, however, want to preserve borrowers' ability to sue lenders and want to ensure that the lending standards aren't too loose.

In the second rule, Dodd-Frank also required banks that package mortgages and other assets into securities hold a portion of the risk themselves, under the theory that this requirement will discourage risky behavior. However, the law directed regulators to come up with an exemption for high-quality loans.

Regulators' initial proposal to require down payments of least 20% for these "qualified residential mortgages" has brought criticism from the banking industry, consumer groups and lawmakers on Capitol Hill. They argue that the regulation, as is, will make it too hard for Americans to qualify for mortgages.

Given the huge amount of pressure on the issue, regulators will "probably have to back off," and impose a down-payment requirement of 10%, said Anthony Sanders, a professor of real-estate finance at George Mason University.

Alan Zibel

Deals & Deal Makers

M&A Faces a Tough 2012, but Spinoffs Could Do Well

Deal makers aren't optimistic about the health of mergers-and-acquisitions activity in 2012, given the lingering uncertainty over Europe and the fragile U.S. economic recovery. Some bankers even say the deals market won't pick up again until 2013. The bulk of deal-making activity will come from global, blue-chip companies that can withstand short-term market volatility and make strategic decisions based on long-term growth, bankers and lawyers predicted.

"Everyone's on the same wavelength that 2012 is likely to be a very tough year," said Thierry D'Argent, global head of M&A at Société Générale's corporate and investment bank in Paris. "It's difficult to be anything but cautious right now."

Many deal makers said companies will try to find creative ways to increase value for shareholders, such as spinning off businesses in a tax-free manner. Spinoffs were popular in 2011, and it's a trend deal makers expect will continue.

The push for spinoffs and breakups in 2011 sometimes came from shareholders, who urged companies to separate low-growth businesses from faster-growing ones so that their holdings could be valued fairly. Shareholder activism is expected to increase this year, with investors pushing companies to merge or sell low-growth businesses in an attempt to improve per-share returns. Deal makers expect this spring's proxy season to be more contentious than last year's.

More M&A activity could also come from nontraditional capital sources, such as pension funds and sovereign-wealth funds, said John Studzinski, global head of Blackstone Advisory Partners LP. In 2011, Blackstone advised on the sale of a 30% stake in GDF Suez SA's oil and gas exploration and production operations to China Investment Corp. for about $4 billion. "The sovereign-wealth funds see fixed assets, like oil, gas, metals and mining, as good, long-term investments," Mr. Studzinski said.

Such funds could also team up with private-equity firms to pursue deals, a trend that has been in the making for some years but is expected to pick up in 2012 as buyout shops look for additional sources of cash. Last year, some private-equity firms remained on the sidelines of M&A activity, partly hamstrung by the lack of financing. KKR & Co. brought in Japanese trading house Itochu to pitch in cash for its $7.2 billion acquisition of oil and gas explorer Samson Investment Co., while Apax Partners teamed up with two Canadian pension funds to buy wound-care products maker Kinetic Concepts for about $5 billion.

Anupreeta Das, Gina Chon and Dana Cimilluca

IPOs

Prospects for a Facebook Offer Brighten a Murky Picture

Initial public offerings were depressed around the world as 2011 drew to a close, but Wall Street appears divided in its prognostications for early 2012.

There are those who believe that fund managers will be more willing to buy IPOs in the new year than they were at the end of 2011, when they were intent on protecting whatever gains they managed to eke out in an up-and-down year in markets.

"I think 2012 is set up to have an incredibly active first quarter because the buy side remains significantly underweight equities now," said Mark Hantho, global co-head of equity capital markets at Deutsche Bank AG.

Though there are many who share Mr. Hantho's optimistic view, there are others who are more cautious given the dynamics of a market that is subject to sudden swings. Since so much of market performance appears to be driven by macroeconomic events in Europe that are unlikely to be resolved quickly, some observers say investors should be prepared for more of the same in the months ahead.

"Our view is that the last six months are indeed a precursor to the next six months," said Mary Ann Deignan, head of Americas equity capital markets at Bank of AmericaMerrill Lynch. "When we come back in January, the issues that investors and bankers are talking about will most likely be the same as now."

On a regional basis, that means Europe will likely be a dead zone for IPOs; Asia will still dominate issuance, but at a slower pace than it saw in early 2011 and throughout 2010; and the U.S. will continue to see new stocks come in fits and starts, as the market allows.

"The U.S. market appears more resilient from the macro themes that are affecting Europe, but there will continue to be times next year when the negative news flows impact the U.S. market as well," said Viswas Raghavan, global head of equity capital markets at J.P. Morgan Chase & Co. "But deals are successfully getting done, both in the U.S. and in Asia, and a decent level of activity is likely to continue out of both these regions."

In particular, there are a couple of high-profile Internet deals waiting in the wings in the U.S. Consumer-reviews website Yelp Inc. has filed to go public in 2012, and social-media giant Facebook Inc. is widely expected to. Investors and private companies will be watching both closely for indications of how they might fare in the wake of online social gaming company Zynga Inc.'s disappointing debut in December.

Lynn Cowan

Hedge Funds

To Stay or to Go? That Is One Question Investors Face

If 2011 felt like a disaster for some hedge-fund managers, there are likely to be aftershocks coming in 2012.

Hedge-fund performance lagged behind that of stock markets for the third straight year in 2011, giving investors reason to take a fresh look at their portfolios and make adjustments. Those adjustments could come in early 2012 in the form of investors pulling their cash from certain managers and putting the money elsewhere.

"What a miserable year for hedge funds," said Vidak Radonjic, of Beryl Consulting Group LLC, who advises on hedge-fund investing. He noted that "redemptions might be very heavy in the first quarter of 2012."

It was just a few months ago that many hedge-fund managers who had significantly performed worse than their peers, particularly those like Paulson & Co., were being highlighted for potential year-end withdrawals. But a rally in October helped stave off the punishment.

Now, in a fresh year, investors will be forced to revisit the question of whether to pull cash—and managers will have a hard time offering a bright outlook given that many of the problems that plagued markets in 2011 remain unsettled.

One prime example: The European sovereign-debt crisis, which drove markets in 2011, seems sent to continue to play out in 2012. The market swings that came as a result of the uncertainty in Europe in the fourth quarter are likely to continue into the new year, managers and investors say.

Managers are also likely to be focused on a ramped-up regulatory environment. In the first quarter of 2012, most managers will be required to register with the Securities and Exchange Commission, if they aren't already registered. This will give investors—and the public—a better look at hedge funds through public filings.

Steve Nadel, a hedge-fund lawyer with Seward & Kissel LLP in New York, said "registration issues will continue to dominate" the discussion in hedge funds in early 2012, but he also predicted changes that could lead to more taxation of the industry and also greater regulation in the wake of the collapse of commodities brokerage MF Global Holdings Ltd.

Still, while the regulatory climate could be increasingly burdensome, there will likely be a wave of hedge-fund launches in 2012. The thinking among some in the industry is that top talent could see this is a good time to branch out and launch a new fund, as payouts possibly diminished because of weak overall fund performance.

Steve Eder

Commodities

Analysts' Biggest 2012 Concern Isn't Supply, but Rather Demand

The risk of an economic train wreck in major consuming countries hangs over commodity markets entering 2012, and could undercut prices even for goods currently in short supply and high demand.

Europe's inability to get its financial house in convincing order hit raw materials hard late last year. And Congress's failure to strike a far-reaching deal on lower U.S. spending was likely the biggest event of the fourth quarter for commodities, according to Colin Fenton, the chief commodities strategist for J.P. Morgan Chase.

"I am very nervous about the near term," Mr. Fenton said. The bank cut its commodities outlook to "underweight" late in 2011, not because the world seemed on the brink of discovering vastly more oil or copper but because of concerns about who would be buying what currently exists.

That is one measure of how serious the economic problems are. Swings in commodity prices are often driven by events like miner strikes or crop damage from harsh weather, but analysts are particularly focused on the bigger picture this year. "Unresolved issues surrounding the sovereign-debt crisis and bank deleveraging will remain overhangs," Morgan Stanley analysts wrote last month. Goldman Sachs sounded a similar note: "The European debt crisis remains a significant downside risk in 2012."

Political events far beyond the commodity markets could also be critical in the year ahead. The sudden change of leadership in North Korea and recent saber-rattling in Iran both point to threats that could send prices spiraling down or rocketing up.

Still, many analysts take an even broader view in the longer run. Fundamental forces that have driven the commodity rally for years—especially an increasing hunger for raw materials in the rapidly growing developing world—are unlikely to be thrown off for long by anything short of economic Armageddon, they contend.

In Mr. Fenton's view, emerging changes in the global commodities trade could even help resolve some of the current problems plaguing heavily indebted developed countries and resource-hungry emerging nations. The "essential solution," according to a recent report by Mr. Fenton, is for China to trade some of its deep reserves of U.S. Treasury debt for abundant supplies of food and growing supplies of energy from North America. Trading Chinese capital for "realistically priced European distressed debt" would also help Europe, the report said.

"Commodities are part of the solution," Mr. Fenton said in an interview. Financial imbalances between the West and China can be adjusted "using the resources we already have."

Liam Pleven

Exchanges

NYSE-Deutsche Börse Tie-Up Hits EU Regulatory Hurdles

The biggest and most politically charged of 2011's attempted exchange mergers ended the year on a cliffhanger, and investors may have to wait until mid-February to find out whether the New York Stock Exchange will have a new—and foreign-based—parent.

European regulators are scrutinizing the planned marriage of Big Board parent NYSE Euronext and Germany's Deutsche Börse AG, a tie-up that would create the world's largest exchange group in terms of listed companies and derivatives contracts traded. The deal struck in February 2011 would create a trading titan domiciled in the Netherlands and poised to partner up with faster-growing markets in Asia.

An estimated €3 billion ($3.9 billion) in trading efficiencies would be welcomed by European banks facing stepped-up capital requirements, and the exchanges tout their combination as giving everyday investors access to a smorgasbord of stocks and financial instruments.

Not so fast, say Brussels's antitrust enforcers.

Fusing NYSE Euronext's prized London futures market with Deutsche Börse's Frankfurt-based derivatives platform matches up plenty of complementary markets, but it also adds up to an estimated 90% of on-exchange futures and options trading in Europe. That point hasn't been lost on smaller exchange operators, which have encouraged European Union authorities to push for divestitures.

The exchange partners have offered to sell swaths of their European options markets, some trade-processing services and even grant rivals limited access to Deutsche Börse's clearinghouse, a cornerstone of the deal. In late December, the exchanges offered to cap some trading fees for a three-year period.

All that may not be enough for EU Competition Commissioner Joaquin Almunia, who has voiced reservations about the deal and could yet seek stricter measures. There is a limit to how far the exchanges are willing to be pushed, however: Executives have promised not to sell either exchange group's futures market in full, saying they would sooner quit the deal.

In the meantime, investors in the companies still aren't sure what the enlarged company will look like. Nearly a year since the deal was struck only two board members and eight executives have been identified—and no name. Executives on both sides are seen leaning toward a new moniker for the parent while keeping the names of the individual markets, including the storied New York Stock Exchange.

Jacob Bunge

High-Frequency Traders

Coming-of-Age Story: Rapid-Style Investing Grows Up

The coming year could see high-frequency trading, a quiet business that powers a huge chunk of the market, step out from behind the screens.

First stop: the floor of the New York Stock Exchange, a place that computer traders have historically avoided in favor of smaller and faster share-trading platforms. Three major electronic market-making firms—Getco LLC, Knight Capital Group Inc. and Virtu Financial—have staked out ground at the Big Board to extend their strategies into new corners of financial markets, giving lesser-known names a growing profile on Wall Street.

Software-powered firms elsewhere are adding staff to promote the use of their mathematics- and statistics-fueled trading algorithms among funds and asset managers, while seeking greater influence in market rule-writing.

"It's not wrong to say that the high-frequency traders are growing up," said Larry Tabb, founder of the Tabb Group, a research firm that studies the structure of financial markets.

Proprietary-trading groups have mined profits by rapidly buying and selling securities, bonds and derivative contracts in sub-second speeds. They often act as market makers, or traders that maintain steady offers to buy and sell on an exchange. Such firms don't have customers in the usual sense and often trade using only their own funds.

This is changing as the biggest firms seek to keep growing and competition approaches the saturation point in sectors like the U.S. stock market. Manning a post on the NYSE floor means interacting with share-issuing companies. Selling trading tools means staffing a sales force and maintaining customer relations.

High-speed traders are also keeping closer watch on regulators, currently crafting new rules for commerce in exotic swap deals that could allow private, electronic firms to compete with Wall Street's biggest banks. There remain separate issues raised by the 2010 "flash crash"—in which high-frequency firms caught criticism for abruptly leaving the market—that could require electronic traders to stick with their trading throughout turbulent conditions. Competing firms have banded together to back advocacy groups in the U.S. and Europe.

There is another reason for firms to map out expansion plans, Mr. Tabb said. Computer-powered trading shops may one day look to sell their own shares as they establish broader-based businesses and private-equity investors seek to monetize stakes taken in recent years.

"You're going to see them move up the value chain into different asset classes, geographies, trading styles and business models," Mr. Tabb said. "A couple smart guys and couple fast computers is not a sustainable, long-term business model."

Jacob Bunge

Stock Trading

Volume Slowdown May Persist as Investors Stay Risk-Averse

A persistent slump in U.S. stock-trading activity is seen extending into 2012 as European debt woes and a sluggish economic recovery in the U.S. give investors few reasons to put money at risk, analysts say.

Exchanges, banks and brokers, already under pressure after two years of declining market volumes, could be forced into further consolidation and restructuring to confront the slowdown.

"We're all coming to grips with the fact that the industry has changed," said Alison Crosthwait, managing director of global market structure for electronic brokerage firm Instinet Inc.

The U.S. stock market closed out 2011 with an average 7.9 billion shares traded per day, about 6% below 2010's daily average of 8.5 billion, which was lower than 2009 levels.

Trading floors are seen being even quieter in 2012. Keefe Bruyette & Woods forecast that an average 7.4 billion shares will change hands per day in 2012, down 7% from 2011, as investors stick to the sidelines after a year of often-jarring volatility.

A jumpy market, liable to turn on a dime based on headlines out of Europe, has made stock-picking harder for individual investors and hedge-fund managers alike, Ms. Crosthwait said. The dominance of big-picture issues—such as the fate of the euro zone—have influenced many securities to trade similarly, slimming the odds that a savvy buyer can zero in on a winner.

"People are looking for some sense of security from Europe, stability in [U.S.] unemployment and consistency out of our federal government," said Ben Schwartz, chief market strategist for Lightspeed Financial Inc.

"Until we get that, it's going to be a rough show." Mr. Schwartz said he anticipates stock-market volumes to otherwise stay flat in 2012.

Slow markets can also be more expensive places to do business. If fewer traders are quoting prices for a given stock, the spread between the bid and offer for that stock is likely to be wider—meaning that an investor will pay more to enter or exit from a position.

Jacob Bunge

Exchange-traded funds

Caveat Investor: Small, Niche Vehicles Are Prone to Closure

The booming exchange-traded-fund industry is still, well, booming. But 2011 showed that ETF closures are probably here to stay, too.

The 1,369 exchange-traded funds in the U.S. are built to track everything from stock indexes like the Standard & Poor's 500 to high-yield bonds and niche areas like nickel and Colombian stocks. Before the financial crisis, fund closures were rare. But fund deaths picked up in 2008 and have remained steady at a few dozen a year as the industry has ballooned to nearly $1.1 trillion in assets under management. In 2011, amid the launch of more than 300 new funds, there were more than 30 closures.

Analysts attribute the closure wave to the rush of new, smaller ETF sponsors seeking to cash in on the boom. While more than 80% of assets in ETFs are in funds sponsored by BlackRock Inc., State Street Corp.'s State Street Global Advisors unit and Vanguard Group Inc., 40 or so smaller firms have the rest of the business. Many aren't as gun shy as the big firms about closing down weak funds. BlackRock's iShares, State Street's State Street Global Advisors, and Vanguard, weren't the sponsors of any of the more than 160 ETFs that closed from early 2008 through mid-October of 2011, according to research by XTF.

"Some of the new entrants into the ETF space are not as careful about the products they launch," said Scott Kubie, chief investment strategist at CLS Investments, which manages $7 billion. "They're hoping to take advantage of a field that's growing quickly. Those ETFs are likelier to close."

To some industry participants, closures are just the ETFs market's way of pruning its unfruitful branches. But a closure can mean a number of headaches, for instance leaving investors on the hook for unexpected capital-gains taxes. It can also upset long-term investors' diversification plans, as the money they plunked into a niche area is returned.

What is certain is that ETF sponsors will face more pressure to close small ETFs in 2012 unless assets under management somehow ramp up sharply. About 53% of all U.S. ETFs manage less than $50 million, up from 43% a year ago, according to XTF. Having $50 million to $100 million is a rule of thumb for industry participants to guess whether an ETF can cover its costs.

Two years is a common time frame to assess whether an ETF should be reconsidered, said Bill DeRoche, chief executive of QuantShares, a company focusing on "market neutral" ETFs.

Most doomed ETFs have been ones that track highly specific investment niches, like the FaithShares Methodist Values Fund, which closed in July, or the MacroShares Major Metro Housing Up Shares ETF, which shut down two years ago. But there are plenty of niche ETFs with low assets and staying power. Whether they close usually comes back to the sponsor, analysts say.

Investors should look to the provider's track record to judge the likelihood of a closure, according to analysts. Meanwhile, the bigger ETF providers take pains to stress that they don't single out a given fund from its larger fund grouping if one happens to be this year's underperformer.

"We want to bring things to market for the long term," says Noel Archard, head of iShares global product development and management at BlackRock. "At any given period, any one of the funds is going to be in favor while others will be out of favor. That's not a concern."

Brendan Conway

Document WSJO000020120102e813005k3

THE WALL STREET JOURNAL.

Personal Finance

Crystal Ball; How many job cuts were there in December?

103 words
31 December 2011
The Wall Street Journal Online
WSJO
English

Send your prediction to crystalball@wsj.com by midnight EST Sunday, with your full name, city, state and phone number. The first reader who gets it right will be named in next Saturday's paper.

On Thursday, Challenger, Gray & Christmas will release its December tally of planned job cut announcements. In December 2010, companies announced 32,004 layoffs. How many were there this year?

Kudos to Omar Darr of Whitefish Bay, Wis., for coming closest to guessing December's State Street Global Markets investor confidence reading of 99.3.

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THE WALL STREET JOURNAL.

Business
Internal BNY Mellon Documents Show Panic

By Jean Eaglesham And Michael Siconolfi
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28 December 2011
The Wall Street Journal Online
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An informant in a state fraud case against Bank of New York Mellon Corp. has provided prosecutors a rare inside peek into how the bank allegedly scrambled to contain the fallout from a fast-growing government investigation, according to hundreds of pages of confidential documents.

As investigators sought to determine whether the bank overcharged clients to execute their currency trades, a senior BNY Mellon executive nicknamed "Rambo" urged traders not to tell clients how much money they made on trading, according to the informant. Bank officials worried clients would switch to negotiating their own foreign-exchange trades, where the bank's profit margin was far lower, an internal bank memo states.

The bank also altered its website, changing the wording of its trading practices. And when a veteran bank official heard about the government investigation, she said: "It's over, it's all over," according to the informant.

The documents, which include company materials, emails and observations, were submitted to Florida prosecutors by lawyers for whistleblower Grant Wilson and obtained by The Wall Street Journal in an open-records request.

Mr. Wilson operated as a government informant for two years while working as a currency trader at BNY Mellon, giving him an extraordinary view of what was happening inside the bank as the investigation unfolded. The extensive documentation, including his descriptions of how the bank processed trades that allegedly resulted in client overcharges, could increase pressure on BNY Mellon as it battles a widening law-enforcement probe.

Five states, including Florida, and the Manhattan U.S. attorney have filed civil lawsuits over the past several months against BNY Mellon, seeking a total of more than $2 billion in damages. The suits allege the bank defrauded pension funds and other clients by systematically overcharging them on currency transactions.

BNY Mellon denies any wrongdoing and is fighting the suits. A bank spokesman said, "A handful of purported statements cherry-picked from millions of documents gathered over a decade, do not reflect the way we do business or the value we provide our clients."

Mr. Wilson declined to comment. His lawyer, Michael A. Lesser of Thornton & Naumes LLP in Boston, declined to comment on the documents, saying the matter is in "active litigation."

Mr. Wilson, 53 years old, is part of a whistleblower group that can seek a share of as much as 25% of any recovery the states obtain in many of the BNY Mellon cases.

He is taking something of a financial gamble. When Mr. Wilson left BNY Mellon in March—after more than a decade working as a trader there—he walked away from deferred bonuses totaling roughly $5 million, according to a person familiar with the matter.

Mr. Wilson in the documents provides intimate snapshots of his colleagues, including details about their families, personal problems and financial standing. The information could be used by prosecutors to help determine who could be witnesses in the case against BNY Mellon—and who could be hostile. Mr. Wilson cited one trader whom he described as "not a happy camper" who "hates the bank as it has not appreciated her vast talent over the years."

Another was valued by managers as a risk taker who "brings guts to the table," Mr. Wilson says in the documents. A colleague deemed by Mr. Wilson as less-talented "spends all his income on exotic fishing trips," he says.

At issue in the suits filed against BNY Mellon is its "standing-instruction" service. That is when pension funds and other clients allow the bank unilaterally to handle their foreign-exchange, or FX, transactions. Clients could instead negotiate their own foreign-exchange trades, but that would require staff and technology.

In the documents, Mr. Wilson described how a "transaction desk" collected currency trades for BNY Mellon's "standing-instruction" clients and then later in the day set the price at which the bank would record those transactions. The prices often were at or near the day's least-favorable exchange rates, state attorneys general and prosecutors allege, with the bank profiting from the difference.

Mr. Wilson describes the pressure inside BNY Mellon after California prosecutors accused rival State Street Corp. in an October 2009 civil suit of overcharging customers in currency trading. State Street denies wrongdoing and is fighting the currency-trading litigation.

Soon after news of the State Street suit, BNY Mellon changed its description of its standing-instruction service, according to copies of pages from the bank's website submitted by the whistleblower. The bank had called the service "free of charge" and designed to help clients "minimize risks and costs."

By November 2009, the "free of charge" wording had disappeared; instead, the bank described its service as a "complete FX solution."

BNY Mellon said in court filings that it routinely updates its marketing materials and the "free of charge" language referred to the fact there was no transaction fee for the currency trades.

Richard Mahoney, former chief of BNY Mellon's global markets division, told an employee meeting in early 2010 that the company had by then received 16 subpoenas, according to Mr. Wilson.

Mr. Mahoney—who the whistleblower said was nicknamed "Rambo" by co-workers for his military background and propensity "to rant and rave"—told staff "we do not have to tell anyone how much money we make on our dealings," according to the informant. Mr. Mahoney, who retired from BNY Mellon earlier this year, couldn't be reached for comment.

The whistleblower also told prosecutors how one of his colleagues in Pittsburgh, Susan Pfister, allegedly reacted when she learned in early 2010 that BNY Mellon, as well as State Street, was being investigated for its currency-trading practices. She said: "It's over, it's all over," according to Mr. Wilson, allegedly reflecting concerns within BNY Mellon that big profits the bank had long generated from standing-instruction currency trading were going to disappear.

Ms. Pfister's alleged comment wasn't included in the civil suit filed by the Florida state attorney general in August, which alleges that BNY Mellon overcharged Florida state pension funds in currency trading.

Ms. Pfister declined to comment through a spokesman for BNY Mellon.

An internal BNY Mellon memo in October 2009 provided by Mr. Wilson said some clients were shifting away from the standing-instruction service to a "negotiated" model—agreeing on the exchange rate for each trade—where the bank's profit margin was lower "by a factor of 10-20 times."

"Once this is done they will never return to their previous model," according to the confidential memo.

The BNY Mellon spokesman said: "We are confident that we provide our clients and their investment managers with valuable foreign-exchange services at competitive prices and the information needed to make informed trading decisions."

After reports surfaced that BNY Mellon was under investigation, executives were torn over how to deal with inquiries from customers demanding to know if they had been overcharged, Mr. Wilson told prosecutors in May 2010. He told prosecutors that Mr. Mahoney "wants to tell them to 'go pound sand,' " but another executive who was "afraid of upsetting custody clients" disagreed.

The documents reveal that at least one other former BNY Mellon employee has offered to help prosecutors build their case against the bank. The salesperson told the Florida attorney general in a letter earlier this year that he could describe how he had been "trained in committing fraud using various strategies."

A spokeswoman for the Florida attorney general declined to comment.

Mr. Wilson faced pressure operating for two years inside BNY Mellon as a secret whistleblower, where he collected internal bank documents and recounted to the government what colleagues said, according to a person familiar with the matter. As news surfaced that an informant was assisting the government in the currency investigation, the bank's foreign-exchange traders grew concerned about a leaker, according to a person familiar with the matter.

On the trading desk, in downtown Pittsburgh, they tried to guess the identity of the whistleblower, asking each other, "Is it you?" this person says.

Mr. Wilson "is concerned about the security of his identity, as he continues to work at the bank," according to a March 3, 2010, letter from his lawyer, Mr. Lesser, to the Florida attorney general's office. "Things are reaching a fever pitch in the office."

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THE WALL STREET JOURNAL.

Personal Finance
Here's What's Really Driving Your Returns

By Joe Light and Ben Levisohn
1,865 words
24 December 2011
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The drama in Europe is putting the best-laid investing plans to the test. Each day, it seems, stocks are either soaring ("risk on") or plunging ("risk off")—yet for the year the Dow Jones Industrial Average has barely budged.

The main culprit: "correlation," or the extent to which assets move in unison, which reduces the benefits of diversification and limits investors' ability to control their portfolios. According to Birinyi Associates, the correlation between the stocks in the Standard & Poor's 500 and the index itself rose as high as 0.86 in October—nearly a perfect 1.0—from as low as 0.4 in February.

But don't despair. By changing the way you spread out your stock holdings, you can reduce risk and boost returns—even in a highly correlated market like today's.

The trick? A concept known as "factor investing," which originated in academia two decades ago and now is finding favor among institutional investors and high-end financial advisers.

Factor investing replaces traditional asset allocation—such as a portfolio with 30% in U.S. stocks, 20% in developed international markets, 10% in emerging markets and 40% in bonds—by focusing on specific attributes that researchers say drive returns. These "risk factors" include the familiar—like small versus large-size companies or growth versus value stocks—as well as more esoteric measures such as volatility, momentum, dividend yield, economic sensitivity and the health of a company's balance sheet.

Some studies have shown that certain factors in particular—such as exposure to small-capitalization and value stocks—give you more return for the amount of risk taken. Other studies have shown that factors have had low historic correlations with one another, making the factor approach increasingly attractive to big institutions looking for true diversification.

Until recently, it was hard for small investors to dabble in factor investing. But that is changing.

In the past year at least six firms—BlackRock's iShares, Russell Investments, Invesco PowerShares, Factor Advisors, QuantShares and State Street Global Advisors—have launched factor-based exchange-traded funds, or have filed paperwork to do so.

Sean Crawford, a portfolio manager at Barclays Wealth who also helps vet new products for the firm, recommends holding off on investing in one of these ETFs until they accumulate at least $100 million in assets and have at least three months of trading history, in order to see how they behave and how well they track the underlying index.

But even if the products aren't quite ready for prime time, investors can use factor investing to their advantage, says Jason Hsu, chief investment officer for money manager Research Affiliates.

What's a Factor?

Factor investing has its roots in academic research from the 1960s. The "capital asset pricing model" identified one factor, beta, or a stock's volatility relative to the index, as pivotal to the stock's returns. The model quickly became a cornerstone of investing theory, and it helped earn William Sharpe and Harry Markowitz the Nobel Memorial Prize in Economic Science in 1990.

In the 1990s, professors Eugene Fama of the University of Chicago and Kenneth French of Dartmouth College's Tuck School of Business found that size (large versus small) and style (growth versus value) also helped explain a stock's returns—and showed that smaller stocks and value stocks that trade at low price/book ratios tend to perform best over time. Their three-factor model is one of the most popular among researchers, though many now include momentum as a fourth factor.

Other studies have identified factors that are less agreed upon, such as a stock's volatility and its sensitivity to gross domestic product. Axioma, a firm that provides risk models and portfolio-construction tools for stock investors, uses 10 factors for U.S. stocks, including exchange-rate sensitivity, debt load and momentum, or the tendency of a rallying stock to keep rallying. MSCI's Barra, a competing firm, uses 12 factors.

Big investors are taking heed. In 2009, researchers assigned to analyze the Norwegian Government Pension Fund recommended it reorient its portfolio around risk factors. And the California Public Employees' Retirement System underwent a similar change in approach in 2010. Other big institutions, such as part of the government pension fund for Sweden, also are exploring how to balance risk factors.

"Pre-Lehman, the focus was on asset allocation" and a diversified approach to active management, says London Business School professor Elroy Dimson, who is also head of the Strategy Council for the Norway fund. "During the post-Lehman meltdown, Norwegians had factor exposures that they didn't know they had."

Ordinary people are factor investors, too—whether or not they realize it. Morningstar's famous style box, for instance, reflects the two best-known factors: style and size. For example, if you keep your entire stock portfolio in the iShares S&P 500 Index Fund ETF, you basically own large-cap stocks with no strong bias toward value or growth. If you own the SPDR S&P Dividend ETF, on the other hand, you have large-cap value stocks (though not as large, on average, as those in the S&P 500 ETF).

Recent research has shown that more exposure to additional factors can juice returns.

"There are a lot of nuances you may be missing by focusing only on style and size," says Savita Subramanian, head of equity and quantitative strategy at BofA Merrill Lynch Global Research. "You may be missing a whole layer of outperformance you could have gotten."

For instance, for investors looking for stability, the traditional choice might be a large-cap value fund. But large-cap value has performed terribly this year: The SPDR S&P 500 Value ETF has dropped 4.5%, more than six percentage points below the S&P 500's return.

Adding a low-volatility tilt could have improved performance, since low-volatility stocks tend to hold up better during market routs. The PowerShares S&P 500 Low Volatility ETF, for example, is weighted toward large-cap value stocks, according to Morningstar, but its low-beta characteristics helped boost performance during recent downswings. The ETF gained 0.1% in August, for example, 6.4 percentage points better than SPDR S&P 500 Value.

How to Use Factors

The first step is to understand your current factor exposure, starting with three factors that most researchers agree on: beta, size and style. Any financial adviser should be able to do a factor analysis for you.

If you are on your own, a good place to start is Morningstar.com. Look up your current holdings and check out the style map, which shows your size and style weightings. If a dot appears toward the upper-right-hand part of the map, for example, it means your portfolio is tilted toward large, growth stocks.

Under the "Ratings & Risk" tab, you can find the fund's three-year beta. A beta of 1 means the fund moves in tandem with the index. If beta is higher than 1, it is more volatile than the index.

Morningstar's style box and risk ratings won't give you as exact a picture of your exposure to each factor as a financial planner's analysis would, but it will help you understand the overall tilts of your portfolio.

Once you see which factors you tilt toward, see if you can find ETFs to duplicate your exposure at a lower cost, says Christopher Van Slyke, a financial planner in Austin, Texas. There are several low-cost small-cap, large-cap, growth and value ETFs to choose from, including those from Vanguard Group, iShares and, if you use a financial planner, Dimensional Fund Advisors.

For example, if you previously have devoted most of your portfolio to broad index funds, you might find that your investments tilt slightly toward growth stocks and heavily toward large-cap stocks. Yet the research by Profs. Fama and French shows that small-cap stocks and value stocks tend to do the best over time.

Instead of putting your entire portfolio in the Vanguard Total Stock Market ETF, for example, you could put 75% in the total-market ETF and 25% in a small-cap-value ETF like Vanguard Small-Cap Value or PowerShares Fundamental Pure Small Value Portfolio. The FlexShares Morningstar U.S. Market Factors Tilt ETF, which launched in September, places the strategy in one package.

Be warned: Small-cap and value stocks can go through long periods of underperformance, and investors must resist the urge to chase returns.

"If you're going to tilt your portfolio to small-cap value, you have to be willing to stick with it," says Rick Ferri, founder of Portfolio Solutions, an investment adviser in Troy, Mich.

Since small value stocks have a higher expected return, investors can increase their allocation to bonds to reduce volatility, says William Bernstein, an investment manager at Efficient Frontier Advisors in Eastford, Conn. Those who had 60% of their portfolios in stocks and 40% in bonds in a market-cap weighted portfolio can put just 50% of their money in stocks in a small-cap value-weighted portfolio, he says.

By design, your new portfolio will no longer simply track a market-cap weighted benchmark, such as the MSCI All-Country World index. So you will have to have the fortitude to stick with the plan when there are times you lag behind broad index funds.

Trading Vehicles

Factor ETFs are particularly suited to short-term bets, says Ms. Subramanian of Bank of AmericaMerrill Lynch. That is because they provide a simple way for investors to add exposure to a particular area without making wholesale changes to their portfolio.

"One way to effectively use them may be as satellite bets on your overall core strategy," she says.

Take an investor with a portfolio of high-quality dividend stocks, like the SPDR S&P Dividend ETF. During tough times, the ETF will typically outperform the overall market. In 2011, for example, it has gained 4.2% without even counting dividends, versus the 2% gain of the S&P 500 including dividends. That investor, however, faces a predicament if the market rallies, since dividend stocks typically trail during market surges. In 2009, for example, the dividend ETF gained 19%, 7.4 percentage points less than the S&P 500.

Rather than selling all the dividend payers, the investor could sell a portion of the portfolio and use the proceeds to buy a high-beta ETF, which should, in theory, perform better if the market rallies. During October, for instance, the PowerShares S&P 500 High Beta ETF gained 19%, nearly double the S&P 500's 10.9%.

The same holds true for other factors like momentum and quality.

"If you're heading into a market where you think high beta will outperform, you can use an ETF to tilt toward beta," Ms. Subramanian says. "It's a happy medium between indexing and active management."

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THE WALL STREET JOURNAL.

Business
After Tip, the Claim For Reward

By Jean Eaglesham
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Whistleblowers alleging that two banks overcharged clients for currency trades could provide an early test of a new U.S. program to encourage tips of possible financial wrongdoing.

The whistleblowers, who are helping the Securities and Exchange Commission in civil investigations into whether Bank of New York Mellon Corp. and State Street Corp. improperly charged customers for currency trades, have filed claims seeking possible bounties from the SEC, according to people familiar with the matter.

The agency's whistleblower program, launched under the Dodd-Frank financial-overhaul act, stemmed from calls for tougher policing of Wall Street following the financial crisis. The plan for the first time offers government bounties to financial insiders and others who tip off the SEC about alleged securities fraud, offering payments of at least $100,000 to those whose information leads to big enforcement penalties.

The agency finalized its whistleblower rule in May and aims to make its first payment under the program next year, according to people familiar with the matter. Under the program, people whose information leads to an SEC enforcement action with penalties of more than $1 million are guaranteed a 10% to 30% cut of the penalties. To receive the money, the SEC must determine the tips provided original information that led to the enforcement action.

In a report Tuesday, the SEC said it received 334 whistleblower tips in the seven weeks when the final rules became effective on Aug. 12 and the Sept. 30 financial year's end.

Among those who have filed SEC whistleblower claims are Grant Wilson, a former BNY Mellon currency trader; and Peter Cera and Ryan Gagne, former State Street currency employees; each has provided the government information about currency activities at their former employer, the people familiar with the matter said. The Wall Street Journal first reported the identities of the whistleblowers last month.

BNY Mellon and State Street have denied any wrongdoing and are fighting civil lawsuits filed by state attorneys general and others in the matter. They said they are cooperating with inquiries by government authorities. Michael Lesser and Philip Michael, the lawyers for the whistleblowers, declined to comment, as did an SEC spokesman. The whistleblowers' cooperation with SEC investigators is likely to increase the legal pressure on BNY Mellon and State Street.Both banks are battling a widening civil law-enforcement probe into allegations that for years they systematically overcharged pension funds and other clients for currency trades. The BNY Mellon and State Street tips are among the first publicly reported possible bounty claims to the SEC.

Jordan Thomas, who helped to craft the whistleblower program before leaving the SEC in July, said the quality of the submissions has been high.

"Some relate to senior people at large financial firms and other corporations, typically hard targets for the SEC to successfully bring enforcement actions against," said Mr. Thomas, now acting on behalf of whistleblowers as a partner at law firm Labaton Sucharow LLP. He has no involvement in the BNY Mellon and State Street cases.

Messrs. Wilson, Cera and Gagne have submitted a mass of information to the SEC about the companies' currency-trading operations, including emails and other internal bank documents, the people familiar with matter said.

The SEC's civil investigations into activities at State Street and BNY Mellon involve similar allegations to those already made in civil lawsuits against each bank filed by state prosecutors and public pension funds, the people said. But they said the agency is looking at a broader range of possible wrongdoing than most of those suits.

The SEC is looking at currency trades the two banks made for private clients, as well as for public pension funds, and investigating the companies' activities across the nation, not just in certain states, the people said.

The allegations against the banks center on claims they overpriced certain currency trades for large institutional clients by using less-advantageous exchange rates to maximize their own profits.

The SEC program isn't the only source of potential payment for the whistleblower group behind the currency-trading allegations, which includes Harry Markopolos, best known for trying to alert the SEC to Bernard Madoff's multibillion dollar Ponzi scheme.

Mr. Wilson and others in the group have a financial stake in civil lawsuits filed by four states against BNY Mellon, seeking total damages of more than $2 billion. These people could collect a share of any damages from these suits of up to $100 million under provisions of the states' false claims acts, people familiar with the matter said.

Messrs. Cera and Gagne and others in the whistleblower group also have a stake in a civil suit filed against State Street in 2009 by California state prosecutors. These people could collect up to 33% of the estimated $200 million in damages sought in that case, according to people familiar with matter.

Mr. Thomas, the former SEC official, said the agency wants to encourage high-level whistleblowers. "If it is a close call whether the information provided by the whistleblowers was significant or not, I think the SEC's going to err on the side of the whistleblowers," he said.

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THE WALL STREET JOURNAL.

Tech
Buffett Bets $10.7 Billion in Biggest Tech Foray

By Serena Ng, Erik Holm and Spencer E. Ante
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English

Billionaire investor Warren Buffett plowed $10.7 billion into the shares of International Business Machines Corp., making a massive bet on a technology services company after years of eschewing technology stocks.

Mr. Buffett on Monday said his Berkshire Hathaway Inc. has taken a 5.4% stake in IBM. The holding is valued at $12 billion at current prices, already reflecting a 12% gain from what Berkshire paid. The acquisition made the Omaha, Neb., conglomerate IBM's second-biggest shareholder at Sept. 30, after investment firm State Street Global Advisors.

Berkshire secretly had been accumulating the shares since March, twice receiving confidential treatment from the Securities and Exchange Commission, which otherwise mandates that big investors disclose their holdings quarterly. Berkshire made its purchases during a period when shares of the information-technology services provider hit new highs while the broader stock market convulsed.

IBM shares have surged 28% this year, outdoing a flat showing in the Standard & Poor's 500 broad-market index and making the company the fourth-biggest U.S. firm by market capitalization, after Exxon Mobil Corp., Apple Inc. and Microsoft Corp. IBM's shares closed Monday at $187.35, down three cents, on the New York Stock Exchange. Berkshire closed 1.3% lower at $113,921 a Class A share.

The investment represents the most Berkshire has ever paid for a minority stake in a publicly traded company. Berkshire has an ever-growing cash hoard that Mr. Buffett must deploy in stocks and businesses in order to meet his goal of increasing the value of his company faster than the S&P 500 index. The IBM investment, along with a purchase in the third quarter of shares in Intel Corp. by Berkshire investment manager Todd Combs, gives the conglomerate holdings in 11 of the 30 companies that make up the Dow Jones Industrial Average.

By investing in IBM, the 81-year-old chairman and chief executive of Berkshire appears to be departing from a long-held aversion to technology stocks. He previously professed to not understand technology companies even though his close friend and Berkshire board member Bill Gates is chairman of Microsoft. Mr. Buffett's investment track record has been built on investments in insurers, financial companies and industrial businesses, including household names like Coca-Cola Co. and American Express Co.

Mr. Buffett said he invested in IBM after reading its most recent annual report and was struck by IBM's entrenched position providing technology services to businesses. That is a characteristic he has long sought in investments, which he calls a "moat" against competition.

In an interview with The Wall Street Journal on Monday, Mr. Buffett said IBM "fits all my principles…it's something we expect to own indefinitely." He said he has completed his purchases of IBM. The SEC issues about 60 confidentiality waivers per quarter to investors, allowing them to accumulate shares without disclosures that could drive up stock prices.

Mr. Buffett said the fact that IBM stock has been trading close to its all-time high didn't matter to him. "What matters is what the company does in the future," he said. Berkshire's investment in IBM was earlier reported by CNBC.

IBM declined to comment on Berkshire's holding.

IBM, founded a century ago, has evolved from what was largely a maker of personal computers into a global provider of software and technology services for big companies and governments. By 2015, IBM aims to double its per-share earnings from 2010, receive 30% of its total revenue from emerging markets and spend $20 billion on acquisitions.

Shares of the Armonk, N.Y., company have ridden this year's tech wave, which has pushed up stocks of many tech and Internet companies and sparked fears among some market watchers of another tech bubble.

The shares are trading at nearly 15 times IBM's 2010 earnings and 12.7 times its projected 2012 earnings, based on analysts' forecasts. That valuation is similar to Oracle Corp. but higher than Microsoft's forward price-to-earnings multiple of 8.5 times.

Mr. Buffett said the idea of purchasing shares in Microsoft is "off limits" to him because of his friendship with Mr. Gates.

Even though Berkshire bought IBM shares during a period in which they often traded near their record high, Mr. Buffett has maintained he tries not to overpay for investments. Last Friday, in a meeting with about 200 business students from colleges around the country, he said that when he buys stocks, he looks for enduring competitive strengths "and something not too expensive."

Not everyone is as bullish on IBM shares as Mr. Buffett. ISI Group analyst Brian Marshall, who has a "neutral" rating on the stock, said shares are "priced for perfection" and likely won't see a significant boost until IBM starts growing revenue more quickly.

Mr. Buffett has long been familiar with IBM, having discussed the company's business with Mr. Gates in the early days of their friendship. Jeff Matthews, a private investor in Berkshire who has written a book about Mr. Buffett, said the billionaire's early view of tech stocks was shaped some 50 years ago when many technology firms were "untested or highly volatile companies that generally flamed out."

Mr. Matthews said Mr. Buffett "probably sees IBM as a company that is as hard to displace from the corporate world as Coke would be to displace from the consumer world."

On the change in how he viewed investing in IBM, Mr. Buffett said: "Sometimes business facts change and it's your job to attempt to understand them."

One change Mr. Buffett will have to keep a close eye on is IBM's management. In October, IBM announced that Virginia M. Rometty will succeed Sam Palmisano as chief executive on Jan. 1 after a nearly 10-year run at Big Blue.

Mr. Buffett said the management change didn't surprise him, as IBM has "retired people fairly young."

Mr. Palmisano has won credit for wrenching decisions, like dumping IBM's PC business in the middle of the last decade, and for using a string of acquisitions to boost the company's exposure to more profitable services and software businesses.

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contributed to this article.

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Buffett Bets $10.7 Billion In Biggest Tech Foray

By Serena Ng, Erik Holm and Spencer E. Ante
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Shara Tibken contributed to this article.

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WEEKEND INVESTOR --- The New Basics: SEC Targets Derivatives Use

By Joe Light
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English

The Securities and Exchange Commission is weighing new limits and disclosure requirements on the use of derivatives in mutual funds and exchange-traded funds, and the fund industry is pushing back.

Investment companies, including Vanguard Group, T. Rowe Price Group, State Street Global Advisors, and industry groups this past week submitted formal comments to the SEC in response to a request from the agency. Many of the firms defended the use of derivatives as necessary tools to manage risk in their funds, though some are amenable to broader disclosure.

Vanguard executives, for example, wrote that the company's funds use derivatives to "achieve a number of benefits for our investors including hedging portfolio risk, lowering transaction costs, and achieving more favorable execution compared to traditional investments."

Derivatives are contracts whose prices are dependent on those of other assets. Some, such as commodities futures, are traded on exchanges, but many are privately negotiated.

Some types of derivatives have been criticized for letting investors take on huge amounts of debt or exposing them to huge risks.

More than 27% of mutual funds hold at least one derivative, according to an analysis by investment research firm Morningstar. The actual number is difficult to determine because there are no uniform disclosure requirements for derivatives, says Nadia Papagiannis, Morningstar's director of alternative fund research.

Stock-fund managers sometimes use derivatives to hedge their exposure to market swings and, for international funds, changes in currency exchange rates, Ms. Papagiannis says. Bond funds commonly use derivatives to hedge the risk of interest-rate changes.

"Painting things with a broad derivatives brush is dangerous," says Dave Nadig, director of research at IndexUniverse, a fund research firm, who notes that many commodities-based exchange-traded funds rely wholly on futures contracts to operate. "If there were a ban on holding derivatives in [those] ETFs, they'd cease to be."

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THE WALL STREET JOURNAL.
U.S. EDITION

'Bucket' List: G-20 Panel Names Top Global Banks --- Large Institutions Will Be Required to Hold More Capital

By Geoffrey T. Smith
547 words
5 November 2011
The Wall Street Journal
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English

CANNES, France -- The enforcement agency for financial stability of the Group of 20 industrial and developing nations Friday published the long-awaited list of those banks it will force to hold more capital because of their importance to the global financial system.

The list of Globally Systemically Important Financial Institutions is very much as had been expected, with 17 European banks, eight U.S. ones, three Japanese and one Chinese on it. Two large European banks, Spain's Banco Bilbao Vizcaria Argentaria SA and Italy's Intesa Sanpaolo SpA, that some expected may be on the list were left off, largely due to their concentration of activities in their home markets.

The banks named Friday by the agency have until the end of next year to lay out in detail how their businesses should be unwound if they collapse. From 2016, they will also have to hold more capital than other banks "in order to reflect the greater cost to the system of their failure." As such, by 2019 at the latest, these banks will have to have a core Tier 1 capital ratio up to 3.5 percentage points higher than banks that aren't systemically relevant.

The agency foresees five "buckets," requiring extra capital of 1%, 1.5%, 2%, 2.5% and 3.5%. The more important the bank, the higher the surcharge it will have to pay. Mario Draghi, the outgoing chairman of Financial Stability Board and the new president of the European Central Bank, said in Cannes Friday that it is still too early to say which bucket the individual banks will be put in, but the 3.5% bucket will be left empty to start with.

The banks have argued that the surcharges will restrict their ability to lend and distort competition. The regulators largely dismissed those concerns in confirming the bulk of their original recommendations Friday.

"Complete and globally consistent implementation of these measures will be essential for a safer and sounder banking system and will contribute to broader financial system stability," Stefan Ingves, chairman of the Basel Committee on Banking Supervision, said.

The Basel Committee has stressed that the capital surcharges are intended as minimum requirements, and has left national regulators free to impose higher ones.

The U.S. banks named on the list are: Bank of America Corp., Bank of New York Mellon Corp., Citigroup Inc., Goldman Sachs Group Inc., J.P. Morgan Chase & Co., Morgan Stanley, State Street Corp. and Wells Fargo & Co. The European banks are: Royal Bank of Scotland PLC, Lloyds Banking Group PLC, Barclays PLC and HSBC Holdings PLC in the U.K.; Credit Agricole SA, BNP Paribas SA, Banque Populaire and Societe Generale SA in France; Germany's Deutsche Bank AG and Commerzbank AG; as well as Italy's Unicredit Group SA, Switzerland's UBS AG and Credit Suisse AG; Belgium's Dexia SA, ING Groep NV in the Netherlands, Banco Santander SA in Spain and Sweden's Nordea AB.

Also on the list are Japan's Mitsubishi UFJ FG, Mizuho FG and Sumitomo Mitsui FG and China's Bank of China.

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THE WALL STREET JOURNAL.

Markets
Questions Swirl Around Jefferies

By Brett Philbin And Gina Chon
765 words
4 November 2011
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WSJO
English

Worries about U.S. financial firms' exposure to Europe came to the fore as Jefferies Group Inc. was rocked by concerns over its sovereign-debt holdings.

Days after securities firm MF Global Holdings Inc. filed for bankruptcy protection after disclosing a $6.3 billion bet on European government debt, Jefferies was forced to respond to a credit-ratings firm report over its sovereign holdings.

Shares of the midsize investment bank fell as much as 20% on Thursday after the release of the report by Egan-Jones, a small credit-ratings firm, before rebounding following Jefferies's statement that it had no meaningful exposure to European debt. The New York Stock Exchange twice had to halt trading in Jefferies's shares. The stock ended down 26 cents, or 2.1%, to $12.01, in 4 p.m. composite trading. The shares have lost 18% since Friday's close.

The sharp moves underline investor worries that, following the demise of MF Global, other small financial institutions that take risks with their own capital and rely on the markets for most of their funding might be under pressure.

Jefferies's travails had an impact on its plans for expansion. On Wednesday, the company met with representatives from State Street Corp. to discuss ways they could work together to build upon their futures-trading businesses, people familiar with the matter said. This week, the two companies briefly had talked about looking at buying parts of MF Global together but, given the concerns raised over Jefferies's own European sovereign-debt exposure, the idea has been largely dropped, the people said.

Jefferies, which is run by CEO Richard Handler, had looked at MF Global over the weekend before the failed brokerage filed for bankruptcy protection, one of the people said. But the investment bank needed more time to study MF Global and saw risks in such a possible acquisition, said a person familiar with the matter.

State Street and Jefferies declined to comment on the takeover talks.

Shares in Jefferies, which has expanded its staff and range of activities in recent years, had been under pressure for most of this week. However, they took a nose dive on Thursday after Egan-Jones downgraded its credit rating to BBB-minus, one notch above "junk" status, from BBB, citing a "changed environment." The ratings firm said "the problems of MF have increased scrutiny of other medium-sized broker/dealers."

Egan-Jones raised questions about the company's "sovereign obligations," saying those positions accounted for a large percentage of the company's shareholders' equity.

Jefferies rebutted those findings, saying recent reports focused only on its $2.7 billion in bets that prices would rise and didn't account for offsetting positions of $2.5 billion that prices would fall.

The firm said it has no credit-default swaps hedging its sovereign-debt exposure, seeking to allay fears such instruments wouldn't be effective in preventing potential losses.

Jefferies said its net exposure to European debt includes $5 million to Portugal, $28 million to Ireland, $104 million to Italy, and $3 million to Greece. Jefferies also said it had a net short position of $178 million related to Spanish government debt, meaning it stands to gain if the price of the debt falls.

Nevertheless, Sean Egan, president of the ratings firm, defended in an interview his company's concerns about Jefferies's sovereign-debt exposure.

"They claim it's beautifully hedged," he said. "Our view is that we're skeptical until we see complete proof of that. We don't know how those shorts are set up and whether they completely offset their $2.7 billion" exposure, he said.

Meanwhile, Jefferies' largest shareholder, Leucadia National Corp., an investment-holding company, purchased one million shares of the investment bank's stock at $11.84. The company now owns 57.5 million shares of Jefferies, according to a regulatory filing Thursday. That equates to about 29% of the investment bank's shares.

While Egan-Jones is one of 10 credit-ratings firms registered with the Securities and Exchange Commission, it has just two credit analysts compared with 1,088 at Moody's Investors Service, 1,109 at Standard & Poor's Ratings Services and 712 at Fitch Ratings, the three largest firms, as of the end of 2010, according to the SEC. Those three firms have Jefferies rated one notch above Egan-Jones's rating, with a stable outlook.

Jeannette Neumann contributed to this article.

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THE WALL STREET JOURNAL.

Markets
MF Global Fights to Live Until Sale

By Aaron Lucchetti, Jacob Bunge and Gina Chon
889 words
29 October 2011
The Wall Street Journal Online
WSJO
English

MF Global Holdings Inc. scrambled to raise cash and position the securities firm for a sale as its stock price sank below $1 at one point on Friday.

The New York company has sold some of its $6.3 billion in European sovereign-debt exposure in recent days, according to people familiar with the situation. Those are the same bets that backfired on the company. It couldn't be determined who bought the positions or at what price, but the sales are believed to be at least in the hundreds of millions of dollars, according to people familiar with the matter.

The push to shore up the broker-dealer for a sale follows an attempt over the past year or so by Chief Executive Jon Corzine, a former chairman and senior partner at Goldman Sachs Group Inc., to remake the company into more of a trading house that makes bets with its own capital.

Several would-be suitors were circling the company, according to people familiar with the situation. One firm in talks with MF Global for a possible buyout is J.C. Flowers & Co., people familiar with the matter said. The private-equity firm has a 6% stake in MF Global held in preferred shares and close ties with Mr. Corzine. The people described the talks between the firms as serious but not exclusive. They cautioned that a deal may not happen.

Mr. Corzine has been working closely with the company's directors and advisers, all of whom are expected to meet throughout the weekend to try to finalize a deal for the company, these people said.

According to traders and Wall Street executives, MF Global also is trying to unload other holdings of European sovereign debt and U.S. government-bond debt at discount prices. These people added that several banks and financial firms are looking at those positions. Sales could help MF Global reduce the level of borrowing, or leverage, on its balance sheet and make the company look more attractive to potential buyers.

The rapid decline at MF Global accelerated during the week as it reported a surprise loss on Tuesday and saw its credit rating get cut to "junk" status by Moody's Investors Service and Fitch Ratings on Thursday.

Junk ratings are perilous for securities firms because their borrowing costs increase and they need to post additional collateral against trades. Junk ratings also rattle customers, and some MF Global clients already were moving business elsewhere, forcing the company to come up with cash, people familiar with the matter said.

Earlier in the week, MF Global fully tapped a $1.3 billion credit facility to build up its cash, a person familiar with the matter said. The company's lenders include Bank of America Corp., J.P. Morgan Chase & Co. and Citigroup Inc., the person said.

MF Global shares fell to as little as 99 cents in New York Stock Exchange trading Friday, before closing down 23 cents, or 16%, at $1.20. The stock has fallen for five days in a row and is down 67% since last Friday.

Apart from J.C. Flowers, Goldman Sachs Group Inc., State Street Corp. and Macquarie Group Ltd. are among companies considering acquiring MF Global or parts of it, people familiar with the matter said. Some companies looking at MF Global haven't yet approached the firm and may not pursue a deal, the people added.

As of Friday, MF Global had narrowed its list of potential partners to about five, a person familiar with the situation said. It wasn't clear how many companies had approached MF Global or the investment bankers hired earlier in the week to help the securities firm sift through its options.

Some longtime clients vowed to stick with the firm. "I think they're going to be OK," said Jon Marcus, principal of Lakefront Futures & Options LLC, a Chicago firm that clears trades with MF Global. Other brokerage customers said they were advising their own clients to approach other clearing firms.

In a research note, Deutsche Bank analyst Michael Carrier said MF Global "needs to move quickly in order to avoid client defections and either work on strategic options or work with the agencies to get back to stable status."

According to company financial statements filed with regulators, the dual credit-rating downgrades could trigger obligations under financing contracts, while some counterparties could opt to terminate contracts.

Dissolving such contracts "could cause us to sustain losses and impair our liquidity by requiring us to find other sources of financing or to make significant cash payments or securities movements," according to the regulatory documents.

MF Global's debt outstanding now trades at distressed levels, despite this past week's agreement on a new strategy to tame Europe's debt woes.

Ryan Dezember and Liz Rappaport contributed to this article.

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Corrections & Amplifications

MF Global Holdings Chief Executive Jon Corzine is a former chairman and senior partner at Goldman Sachs Group Inc. An earlier version of this article said he was a former CEO at Goldman.

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THE WALL STREET JOURNAL.

Business
BNY Mellon Faces Forex Fraud Case in Massachusetts

By Liz Moyer
404 words
26 October 2011
12:38 PM
The Wall Street Journal Online
WSJO
English

Massachusetts's securities regulator on Wednesday leveled civil charges against Bank of New York Mellon Corp. for allegedly defrauding a state pension fund through undisclosed markups in foreign currency exchange over a decade.

The administrative case, where the parties hold a judicial proceeding outside of court under Massachusetts law, seeks the return of allegedly "tens of millions" in illegal profits, a fine, and a cease-and-desist order. It is the latest in a string of cases lodged against BNY Mellon, the biggest U.S. custody bank, in a growing currency-trading scandal.

Regulators have been examining how firms like BNY Mellon and its rival State Street Corp. process currency transactions for clients, including allegations that they routinely overcharged for such services. State Street is also facing lawsuits, and Massachusetts has an open investigation into the bank.

Massachusetts Secretary of the Commonwealth William Galvin on Wednesday accused BNY Mellon of stealing millions from pensioners of a $41.3 billion fund run by the Massachusetts Pension Reserves Investment Management Board. The official said the bank was aided by a lack of transparency in the business that allegedly prevented the fund from detecting hidden currency-exchange markups over 10 years.

BNY Mellon has denied allegations of wrongdoing. "This administrative action recycles baseless allegations, and as we've stated previously we are confident that we will prevail on the facts and the law," said Jeep Bryant, a spokesman. "We provide all clients with a valuable service at competitive prices and any suggestion otherwise is simply wrong."

Earlier this month, the Justice Department and the New York attorney general filed separate civil cases against the bank alleging it fraudulently charged clients, including a variety of state pension funds, private companies, universities and banks, for currency transactions. During the summer, state attorneys general in Virginia and Florida filed civil suits against the bank making similar allegations. BNY Mellon also faces suits by a whistleblower group.

The Massachusetts pension fund, which goes by the acronym PRIM, invests the assets of the state teachers' and employees' retirement systems and county, district and municipal retirement systems that choose to invest with it.

The Massachusetts case cites a study commissioned by the pension fund that said BNY Mellon overcharged it by approximately $30.5 million. The fund was once the sixth-largest public fund client of BNY Mellon, the suit said.

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THE WALL STREET JOURNAL.

Personal Finance
Investing With the Activists

By Joe Light
1,046 words
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The Wall Street Journal Online
WSJO
English

A number of high-profile "shareholder activists," from Carl Icahn to Nelson Peltz, have set their sights on companies this year. The strategy: Buy big stakes and then agitate for strategic changes to boost shareholder value, from small operational tweaks to selling the entire company.

Does it make sense for ordinary investors to try to go along for the ride?

In short, maybe. Piggybacking on activists' investments can indeed pay off, say researchers, but their strategies can be difficult to follow and fraught with risk.

This week, Mr. Peltz, of Trian Fund Managment, sent a letter to financial firm State Street saying he might take a more active role in the company. On Oct. 11, merchant bank Jaguar Financial pressured tech giant Research In Motion to sell itself or break up. And Mr. Icahn, of Icahn Capital, recently disclosed a near 10% stake in engine-maker Navistar.

Many more activists are working behind the scenes, says Damien Park, managing partner of activist consulting-and-research firm Hedge Fund Solutions. This year through Oct. 10, Mr. Park's firm has tracked 279 formal requests for structural or management changes, up from 265 during the same period a year ago.

"There's an extraordinary amount of activism going on. It's the busiest I've seen it since 2006," Mr. Park says.

Activists typically disclose their involvement in a company through a so-called 13-D filing, which they are required to file within 10 days of acquiring more than 5% of a company's shares. Institutional money managers with assets of more than $100 million also must disclose their holdings in form 13-F every quarter.

Some such filings can happen quietly, but at some point, activists loudly proclaim the changes they want to see in public letters or news releases and try to round up other shareholders to pressure company management.

Whether activists actually improve company performance or are just out for a quick buck is hotly debated. But some research has shown that investors who chased them into a stock have been rewarded handsomely.

One 2008 study by Duke University professor Alon Brav and other researchers found that an investor who constructed an equally weighted portfolio that bought activist targets a month after the initial filing, and held it for three months afterward, beat the market by more than one percentage point a month, on average, after adjusting for risk and other factors. But Prof. Brav notes that the outperformance disappears if all of the conditions aren't met.

Research in 2007 by Harvard University professor Robin Greenwood and then-student Michael Schor found that companies that become the target of an activist are more than twice as likely to be acquired within a year than companies that aren't targeted. The targets that were ultimately taken over had risk-adjusted returns 15% and 20% better than the overall market—but companies that missed the boat didn't have any outperformance.

If you want to try to follow activists' purchases, there are a few things you have to keep in mind.

For one, trying to keep track of proposed company buyouts can be a full-time job, notes Todd Sullivan, who writes investing newsletter ValuePlays.net and recently started a hedge fund.

Shares of Clorox, for example, fell 5% in one day in September when Mr. Icahn dropped his push for a sale of the company. "You needed to watch that situation minute by minute," Mr. Sullivan says.

And even successful activists have flame-outs. In 2008, Mr. Icahn launched a public battle with Yahoo's board to push the Internet search company into a merger with Microsoft, which had offered to buy Yahoo at $33 a share. Mr. Icahn ultimately won a few seats on Yahoo's board and at one time owned as many as 75 million shares, more than 5% of the company. But the sale didn't happen, and by early 2010 he had cut his stake to 12 million shares.

If you had followed Mr. Icahn into Yahoo when he first confirmed he would launch a proxy fight in May 2008, you would now be sitting on losses of more than 41%.

"If you look at a Microsoft or Yahoo situation, you can immediately see that there weren't activist investors who held a large enough stake to realistically effect change," Mr. Sullivan says.

Mr. Icahn says he believes investors who followed his 13-D filings would have performed better than those who followed his 13-Fs, but says he wouldn't recommend either as a strategy.

Some activists' strategies also are difficult to replicate, and not all have good performance, says Mazin Jadallah, CEO of AlphaClone, which builds portfolios intended to replicate many hedge-fund strategies.

Retail investors should stick with hedge-fund managers who keep positions in companies they buy for an average of a year, Mr. Jadallah says. That way, you can follow managers' 13-F filings, which institutional money managers must file quarterly to disclose their holdings, rather than trying to keep track of every 13-D a manager sends out.

Still, a 13-F won't include any short positions the fund has and many other kinds of holdings.

You also should be prepared to stick with a tracking strategy for at least five years, says Zack Miller, author of Tradestreaming.com, a site that follows the trading habits of activists and other managers. Even good managers have two- to three-year stretches of underperformance, he says.

For example, a portfolio that bought the top-10 holdings of Bill Ackman's Pershing Square Capital and rebalanced into his top 10 every quarter would have lost more than 22% this year, according to AlphaClone. But since the fund's first filing in January 2006, such a strategy would have gained almost 27%, compared with just a 6% gain for the Standard & Poor's 500-stock index.

Rather than tracking an activist's portfolio exactly, you can use 13-F filings to home in on stocks that look undervalued even without activist involvement.

"Pick managers and companies you understand. If you don't understand the underlying company, investing alongside an activist is just gambling," Mr. Sullivan says.

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THE WALL STREET JOURNAL.

Business
Fees Boost Trust Banks' Profits

By David Benoit
717 words
19 October 2011
02:05 PM
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WSJO
English

NEW YORK—The increasing pressure on revenues in the financial world is driving profits higher for the bankers' banks.

Bank of New York Mellon Corp. and Northern Trust Corp., two of the country's biggest custody banks, reported Wednesday surging fees and new business wins in their third quarters. Coupled with State Street Corp.'s report of improved revenues Tuesday, the triumvirate of trust banks is getting a boost from the banking world's trouble.

With new global regulations making it harder for financial institutions to make profits on many activities, the financial world has been retrenching, cutting jobs and initiating massive efficiency drives. Much like manufacturers shipping parts around the globe, financial institutions sometimes find it more efficient to ship some work to their banks.

But while revenues are boosted, the trust banks are also struggling with the same pressures. In particular, the custodians continue to see deposits soar, as clients are hoarding increasing amounts of cash in the face of global concerns. Those deposits are crimping margins, leading them to talk about cost savings themselves.

Bank of New York, the biggest of the three by assets, said clients are asking it to perform activities they would have normally done themselves. The bank said its pipeline of business rose significantly, half of it coming from financial companies. It pointed to the concerns about the global economy, particularly in Europe, for the changes.

"I would say the environment is not good, people are very concerned," Bank of New York Chief Executive Gerald Hassell said. While the bank expects the fees to stay flat in the fourth quarter, Mr. Hassell added the outsourcing is "a long-term trend."

Bank of New York's fee revenue rose 8.5% in the third quarter from a year earlier, pushing total revenue to $3.69 billion, up 8%. The bank's profit rose 8.7% to $651 million, or 53 cents a share, a penny better than expected by analysts polled by Thomson Reuters.

At Northern Trust, the smaller of the three, fee revenue jumped 6% on new business and some acquisitions. The Chicago bank's total revenue rose 9%, to $971.5 million, as profit climbed 9.5% to $170.4 million, or 70 cents a share.

On a conference call, Chief Financial Officer Michael O'Grady said the European crisis is causing volatility. "Certainly, from a client standpoint, that presents opportunity for us on the business side, which we're aggressively pursuing," Mr. O'Grady said.

State Street had said Tuesday its fees rose across the board.

"As expense pressures intensify for our clients, they are increasingly looking to outsource more services to us," said Jay Hooley, the Boston bank's chairman and CEO. "At the same time, clients are facing regulatory pressures and look to us."

But concerns over the world's economy are driving more than fees—deposits are coming too. Bank of New York's deposits jumped 45% from a year earlier, though Chief Financial Officer Todd Gibbons said the pace stabilized after surging early in the quarter. Northern Trust's deposits rose 34% and State Street's grew almost 30%.

Normally a sign of strength and source of liquidity, deposits have become a burden on the banks. The trusts say they are uncertain how stable the deposits are and therefore can only safely put them at the Federal Reserve or other short-term investments, which earn little. That ruins margins.

Bank of New York's net interest margin, the profitability measure in lending, fell to 1.3% from 1.67% a year earlier. At Northern Trust it fell to 1.25% from 1.44%, while State Street's dropped to 1.56% from 2.36%.

The crush led Bank of New York Mellon to announce in August it would charge some customers for excess deposits, but Mr. Gibbons said Wednesday customers had adjusted and no customer had yet been charged. The bank is also discussing restructuring other fees with clients, he said.

Shares of the banks had traded higher earlier Wednesday, but slipped as the broader market fell. Bank of New York Mellon lost 0.4% to $19.68 while State Street slid 0.9% to $37.14. Northern Trust fell 1.7% to $38.14.

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English

STATE STREET

Profit Edges Up as Bank

Eyes Europe for Deals

State Street Corp. reported a 1.6% increase in third-quarter profit as well as an interest in making acquisitions in Europe and buying back more of its stock.

For the third quarter, State Street reported a profit of $555 million, up from $546 million a year ago. State Street bought $5.8 million of its stock in the third quarter and has $225 million left from its buyback program.

Revenue rose 5% from a year earlier, to $2.4 billion.

Chairman and Chief Executive Joseph Hooley said the bank is prepared to use its capital for acquisitions, particularly in Europe.

-- Matthias Rieker

CAPITAL REPORT

China Pares Holdings

Of Treasury Securities

Major foreign investors bought Treasurys in August amid Europe's sovereign-debt crisis, with the exception of top holder China, the Treasury Department said.

Monthly Treasury international capital flows surged in August after strong net outflows the month before, according to the Treasury International Capital report. Net foreign capital inflows were $89.6 billion, compared with an outflow of $52.4 billion in July.

China sold Treasurys in August, reducing its net holdings by $36.5 billion to $1.137 trillion.

Japan, the U.K., and Switzerland all bought Treasury securities in August. Japan continued to boost its holdings to record levels, hitting $936.6 billion, up from $914.8 billion in July and remaining the second-largest holder of Treasurys.

-- Ian Talley

EUROPEAN UNION

Lawmakers Agree to Limits

On 'Naked' Short Selling

European Union lawmakers agreed on legislation that limits the use of sovereign credit-default swaps and "naked" short selling of government bonds and stocks.

The legislation agreed to on Tuesday would prohibit naked sovereign credit-default bets when they aren't used to hedge a correlating exposure. Traders also will be obligated to meet reporting requirements on significant short positions to show that they have borrowed the shares or debt involved.

The agreement requires formal adoption by the European Council and the full European Parliament.

Naked short selling is when an investor bets against a financial product without holding the underlying asset.

-- Riva Froymovich

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THE WALL STREET JOURNAL.

Business
State Street Profit Edges Up

By Matthias Rieker And Mia Lamar
581 words
18 October 2011
01:50 PM
The Wall Street Journal Online
WSJO
English

State Street Corp. reported a 1.6% increase in third-quarter profit as well as an interest in making acquisitions in Europe and buying back more of its stock.

The comments come as the Boston bank is dealing with pressure from activist investor Trian Fund Management LP, which has demanded the bank improve returns and has alleged "a culture that has prioritized growth over profitability."

Chairman and Chief Executive Joseph Hooley on Tuesday responded to Trian by touting State Street's "track record of profitable growth" and "strongest capital position among our closest peers."

Mr. Hooley said the bank is prepared to use its capital position for acquisitions, particularly in Europe, where concerns about financial institutions could result in consolidation there.

"Without being specific, it feels to me like we're getting closer" to a pickup in mergers-and-acquisitions activity, he said. State Street is looking for deals valued between $500 million and $2 billion.

Mr. Hooley also told investors that State Street "would like to get more capital back to shareholders, so buybacks are a bit of a priority for us." Like many large banks, State Street has to go through a regulatory stress test early next year to get approval for dividend increases and fresh share buybacks.

State Street bought $5.8 million of its stock in the third quarter and has $225 million left from its current buyback program.

The CEO's comments jump-started the company's share price, which rose 6.6% to $36.08 in recent trading. Before Tuesday, the stock was down 27% in 2011.

As one of the country's largest banks acting as a custodian for investment firms' securities and other back-office duties, State Street has benefited from strong deposit growth—but less opportunity to earn money with those deposits because interest rates remain low. Turbulent capital markets further hurt the Boston company's earnings.

For the third quarter, State Street reported a profit of $555 million, up from $546 million a year ago. On a per-share basis, which reflects payment of preferred dividends, earnings rose to $1.10. Analysts polled by Thomson Reuters expected a profit of 88 cents.

"Strong results in custody and FX, coupled with decent expense controls, delivered the beat" to analyst estimates, Ken Usdin of Jefferies & Co. said.

Revenue rose 5% from a year earlier but fell 3% from the previous quarter, to $2.4 billion, driven by new clients and stronger foreign exchange revenue, the bank said. Both fee revenue and expenses rose 18% from a year earlier. Like many banks, State Street is planning to cut costs.

Revenue at State Street Global Advisors, whose clients include nonprofit organizations, corporations and pension funds, rose 17%, to $229 million. Total assets under management fell 4.2%, to $1.877 trillion.

"On balance, the core business held in better than expected," Macquarie Capital analyst John Moran wrote in a research note.

Deposits rose almost 30% from a year earlier, to $135 billion, and even non-interest bearing deposits more than doubled, to $36 billion. State Street competitor Bank of New York Mellon Corp. recently started to charge some customers to keep their large deposits.

State Street parked $42 billion deposits with the Federal Reserve, 72% more than the amount of deposits parked at central banks a year earlier. The bank's investment in securities held for sale increased 20%, to $97 billion.

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THE WALL STREET JOURNAL.

Business
Peltz Trian Fund Seeks Changes at State Street

By Gina Chon
895 words
17 October 2011
11:12 AM
The Wall Street Journal Online
WSJO
English

Activist investor Nelson Peltz's fund has turned its sights to State Street Corp., publicly calling for the trust bank to become more profitable and consider a spin off or sale of its investment-management division.

Mr. Peltz's fund, Trian Fund Management LP, said the bank has focused on expansion and increasing revenue at the expense of profitability and returning capital to shareholders, according to a letter sent to the State Street board on Sunday evening, along with an earlier paper outlining Trian's suggestions for the bank.

"Despite being a leader in an attractive industry, [State Street] has generated negative shareholder returns," wrote Trian, which now owns about 3.3% of State Street, up from a 1.2% stake. "It has become clear that State Street is not willing, to date, to publicly commit to the actions we view as necessary to enhance long-term shareholder value."

Representatives for State Street, based in Boston, couldn't be immediately reached for comment.

People familiar with the matter said State Street has been restricted by the Federal Reserve in terms of how much capital it can return to shareholders. They added that a call by Trian for a long-term earnings margin target at State Street of 35% was unrealistic. State Street had an earnings margin of 27.3% last year.

Trian's move comes as State Street has been sued by California for allegedly overcharging pension funds for foreign-exchange trading services. The bank has denied the allegations and has said it was releasing more details on pricing.

State Street is one of the country's largest trust banks, acting as a custodian for investment firms' securities and handling other back-office chores.

The bank also has a major investment management arm, State Street Global Advisors, whose clients include pension funds, nonprofit organizations and corporations. That division is in the booming business of so-called exchange-traded funds, which include funds that are based on indexes and that trade on exchanges, like stocks.

Trian is pushing the bank to consider selling or spinning off State Street Global Advisors, saying such a move would unlock value. Asset managers usually have higher valuations than custody banks, Trian said. It cited BlackRock Inc.'s purchase of Barclays Global Investors in 2009 as an example of what could happen to an independent State Street Global Advisors.

But State Street Global Advisors has synergies with State Street's investment-service arm, sharing customers, complementary services and shared costs, people familiar with the matter said. Trian is also the biggest shareholder in asset management firm Legg Mason Inc., which could be a partner for State Street Global Advisors if it is sold, the people added.

State Street, which has a market capitalization of about $17 billion, competes with Bank of New York Mellon Corp., BlackRock, Northern Trust Corp. and others. Its stock is down about 27% this year, which is worse than the broader market but better than the stock performance of BNY Mellon and Northern Trust. State Street is scheduled to report quarterly results Tuesday.

So-called activist investors, who often acquire stakes in companies to push for change such as a sale or spinoff, have been busy lately, amid weak market conditions that often leave boards and executives more willing to respond to shareholder suggestions.

Trian, founded by Mr. Peltz, Peter May and Edward Garden was one of several investors that pushed Kraft Foods Inc. to spin off its North American grocery unit to focus on its global snacks business, a move announced in August. In September, Family Dollar Stores Inc. agreed to appoint Trian's chief investment officer, Mr. Garden, to the discount retailer's board after Family Dollar declined an acquisition proposal from Trian.

Trian began talks with State Street in the summer of 2010 and presented a white paper to the bank in June, according to people familiar with the matter.

Trian argued that many companies set specific targets while allowing for flexibility for unpredictable events.

Last November, State Street announced it was cutting up to $625 million in costs by 2014. Trian argues if those costs affect the company's bottom line, setting a long-term earnings margin target of 35% is a reasonable goal.

Trian also argues that State Street has overpaid in some acquisitions, such as the $1.9 billion acquisition of the security service business of Italy's Intesa Sanpaolo SpA in 2009 and the $4.5 billion deal to acquire Investors Financial Services in 2007.

While State Street has expanded in size and revenue, its costs have gone up even further, according to Trian's white paper. Net revenue grew 21% from 2006 to 2010, while expenses increased 30% during that same period, said the presentation, which said compensation hasn't been adequately managed. At the same time, earnings margins fell to 27.3% from 32.1%.

Instead of focusing on growth, returning shareholder capital should be a priority, such as a share buyback, Trian argues.

In July, the bank reported a second-quarter profit of $513 million, or $1 a share, up 19% from $432 million, or 87 cents a share, a year earlier. Revenue increased 8% to $2.49 billion.

Anupreeta Das

contributed to this article.

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Peltz Trian Fund Seeks Changes at State Street

By Gina Chon
775 words
17 October 2011
The Wall Street Journal
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English

Activist investor Nelson Peltz's fund has turned its sights to State Street Corp., publicly calling for the trust bank to become more profitable and consider a spin off or sale of its investment-management division.

Mr. Peltz's fund, Trian Fund Management LP, said the bank has focused on expansion and increasing revenue at the expense of profitability and returning capital to shareholders, according to a letter sent to the State Street board on Sunday evening, along with an earlier paper outlining Trian's suggestions for the bank.

"Despite being a leader in an attractive industry, [State Street] has generated negative shareholder returns," wrote Trian, which now owns about 3.3% of State Street, up from a 1.2% stake. "It has become clear that State Street is not willing, to date, to publicly commit to the actions we view as necessary to enhance long-term shareholder value."

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Anupreeta Das contributed to this article.

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THE WALL STREET JOURNAL.

Business
Secret Informant Surfaces in BNY Currency Probe

By Carrick Mollenkamp
2,280 words
12 October 2011
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WSJO
English

For a decade, Grant Wilson toiled on a small trading desk at Bank of New York Mellon Corp. in Pittsburgh, buying and selling currencies for the bank's biggest clients.

Mr. Wilson also had another job: For the last two of those years he was a secret whistleblower, assisting currency-trading investigations of BNY Mellon, according to people familiar with the matter.

His input culminated with the filing last week of separate civil lawsuits by the Justice Department in federal court and New York attorney general in state court alleging that BNY Mellon systematically overcharged investors on billions of dollars of currency trades, defrauding or misleading them for a decade.

The suits seek a total of more than $2 billion from the bank. BNY Mellon denies wrongdoing and is fighting the legal actions.

The allegations against BNY Mellon represent one of the broadest enforcement efforts ever against banks that trade in global currencies—one of the world's biggest financial marketplaces. Massive pension funds that oversee hundreds of billions of dollars for teachers, police and firemen and retirees now are questioning whether they got a fair shake on currency transactions that generated profits for the banks.

Until now, Mr. Wilson's identity remained a closely kept secret. His role as a lone whistleblower against BNY Mellon went undetected even as the bank's lawyers looked for a whistleblower.

He left the bank this year after providing information and documents that helped the government and a whistleblower legal group. To pull off two years of secrecy, he and his legal team used a shell partnership in Delaware, met on a Saturday so Mr. Wilson wouldn't be missed at the office, and talked strategy at anonymous restaurants.

Mr. Wilson, along with two lawyers and two other whistleblowers in a separate case, are part of a group that includes Harry Markopolos—the fraud investigator best known for his early, and correct, suspicions that Bernard Madoff's multibillion-dollar investment empire was a fraud. Mr. Markopolos says his group's currency-trading allegations have roots in a hunch he had in 2006 that currency-trading costs might be causing unusual gaps in investment returns.

The group first filed their own lawsuits against the two banks, using information from the whistleblowers, according to people familiar with the matter. State attorneys general then ultimately filed their own lawsuits in four states, believing the whistleblower claims had merit. The whistleblower group can seek a share of as much as 25% of any recovery the states obtain in many of the cases.

State attorneys general in Virginia, Florida and New York and the Justice Department allege BNY Mellon overcharged major clients by giving them unfavorable currency-exchange rates. The alleged fraud involved banking clients that don't negotiate currency trades themselves, but instead give "standing instruction" to a bank to trade for them. These clients usually aren't trading currencies for profit, but simply need foreign money to do transactions overseas.

Mr. Wilson described to his lawyers, and later, law-enforcement officials, how the alleged scheme worked at BNY Mellon and provided internal documents showing the bank's profits. The Wall Street Journal pieced together this account of his role from court documents and extensive interviews with bankers, lawyers and people familiar with the government inquiries.

Mr. Wilson, 52 years old, declined to comment.

In a related case, state prosecutors in California have sued rival State Street Corp., accusing it of improperly pricing currency trades. The Securities and Exchange Commission also is investigating State Street, according to a regulatory filing. State Street strongly denies the allegations.

BNY Mellon sought to discover the insider's identity and to fight the lawsuits. The 225-year-old bank also set up a website to answer client questions and last week ran full-page advertisements in major newspapers saying the claims against it "are flat out wrong and we will fight them in court."

A BNY Mellon spokesman rejected the notion the bank provided "least favorable" currency rates to clients. "We provide competitive wholesale pricing for retail-sized transactions," he said, adding "our clients and their investment managers have full discretion to execute foreign-exchange trades through us or any other provider."

Mr. Wilson, an expert in trading Japanese yen, worked on a BNY Mellon trading desk in Pittsburgh, some 375 miles from the bank's headquarters at One Wall Street in New York. On that desk, the whistleblower—identified by people familiar with the situation as Mr. Wilson—"had extensive personal contact with the employees and executives" behind the alleged fraud, according to the Virginia attorney general's complaint.

According to the Virginia and Florida attorney general suits, a separate "transaction desk" was responsible for collecting the currency trades made for the bank's "standing instruction" clients and then setting the price at which the bank would record those transactions. The prices often were at or near the day's least favorable exchange rates, state attorneys general and prosecutors allege, with the bank profiting from the difference.

State attorneys general allege that emails and internal communications from BNY Mellon show executives endorsing the alleged currency-transaction practice, favoring certain clients with better pricing, and worrying that profit margins would fall if the bank were more transparent. The ability of bank clients to monitor transactions more closely would "reduce margins dramatically," according to an email in Virginia's lawsuit, filed in August in state court.

As the BNY Mellon currency-trading investigations grew, Mr. Wilson's colleagues in the office wondered who the whistleblower might be, according to people familiar with the situation. Mr. Wilson's lawyers gave him language to use if he were ever questioned: He was to refer to himself as a "relator"—a whistleblower, in legal parlance—and say, "I'm pursuing a false-claims case against this company." The explicit language was designed to give Mr. Wilson legal recourse if the company were to retaliate against him for being a whistleblower, these people say.

The investigations focus on an opaque area of the foreign-exchange business, where $4 trillion is traded daily. BNY Mellon and State Street are two of the world's largest "custody" banks, which specialize in processing trades and handling administrative tasks for global money managers including pension funds, corporations, universities and other banks.

Mr. Wilson's decision to become a whistleblower started with Mr. Markopolos, the fraud investigator, who had the 2006 hunch about currency-transaction costs. Over the past four years, he and his legal team contacted Mr. Wilson and two former State Street employees, Peter Cera and Ryan Gagne, to secretly help build cases against the two banks. The whistleblower group is led by two lawyers, Michael Lesser in Boston and Philip Michael in New York.

Working with the legal team, Mr. Markopolos arranged clandestine meetings with the whistleblowers at a shopping center and hotel restaurants. The secrecy paid off. Messrs. Cera and Gagne's names have remained confidential until now. The two former State Street employees declined to comment.

The group organized Delaware partnerships, with the three whistleblowers as the partners, in order to keep their identities out of public view. Messrs. Lesser and Michael are the lawyers for the partnerships. Mr. Markopolos works as a litigation consultant to the lawyers.

The reconstruction of the whistleblower group's formation is based on court documents, obituaries, real-estate records, currency-trading industry materials and the accounts of 10 people familiar with the situation.

Mr. Markopolos's hunch came from a book by Yale University's chief investment officer, in which a description of currency transactions stuck out: "Foreign exchange translations may influence returns in a substantial, unpredictable manner." Mr. Markopolos also noticed that pension funds using outside money managers reported slightly lower returns than the money managers themselves.

He asked a friend who had worked at State Street, who told him that custody banks typically charge pension funds unfavorable foreign-exchange, or FX, prices. The friend told Mr. Markopolos, "No one ever checks FX."

He strategized about how to find bank insiders who could help him look into his suspicions. A key tactic: Looking for traders who might be sympathetic, then cold-calling them and saying, "I have a better job for you."

Working from a small home office in Whitman, Mass., he began to try to contact whistleblowers, including Mr. Cera whom he knew through the Boston securities and banking community. A former senior currency researcher at State Street, he told Mr. Markopolos that allegedly improper currency trading was one reason he had left State Street.

Mr. Markopolos asked Mr. Cera for another State Street insider. He suggested Mr. Gagne. By this time, Mr. Gagne also had left State Street, where he was a currency salesman and worked with the bank's computer systems. Mr. Gagne eventually agreed to join.

In April 2008, the whistleblower team, using information from Messrs. Cera and Gagne, filed a sealed lawsuit against State Street on behalf of two major pension funds, California State Teachers' Retirement System and the California Public Employees' Retirement System, or Calpers.

The suit was filed by an anonymous Delaware partnership called Associates Against FX Insider Trading. It alleges State Street charged the two California funds unfavorable currency rates, determining the prices between 4 p.m. and 5 p.m. each day so the bank could take advantage of daily price fluctuations. The complaint says State Street referred to public pension funds as "dumb" clients compared with "smart" clients who negotiated currency trades to get a better rate.

In a statement, a State Street spokesman said, "Neither Mr. Cera nor Mr. Gagne's job responsibilities included managing or executing indirect FX transactions." She said Mr. Cera left in 2001 and Mr. Gagne left in 2004, well before the 2008 complaint filed in California. She said the bank offers "clients and their investment managers a range of FX execution options and transparency as to our pricing methods" and that the bank will defend against the California allegations.

Meantime, Mr. Markopolos and the legal team contacted Mr. Wilson. Both Messrs. Cera and Wilson had worked at State Street.

On Sept. 12, 2009, Mr. Wilson met with the two lawyers, Messrs. Lesser and Michael, in Boston on a Saturday at Mr. Lesser's firm, Thornton & Naumes. Mr. Wilson didn't take much time away from work and didn't want to raise any suspicions by being out, according to people familiar with the situation.

Mr. Wilson and the lawyers discussed what was at stake during a three-hour meeting. Mr. Wilson claimed that all the standing-instruction trades were made at the same time in the afternoon, according to court documents.

In fall 2009, California's then-attorney general, Jerry Brown, sued State Street in Sacramento state court. In a news release, Mr. Brown cited the whistleblowers's earlier suit and alleged that the bank had charged the state's pension fund at or near the "highest rate of the day." The state estimated that damages and penalties could exceed $200 million.

The State Street lawsuit in California quickly caused headaches over at BNY Mellon. An internal BNY Mellon monthly business report in November 2009 said, "The fallout from the State of California vs. State Street lawsuit continues. To date BNYM has received 42 queries from clients questioning our policies and procedures."

In late October, the whistleblower group finalized suits against BNY Mellon in several states. The group filed papers to form a Delaware general partnership called "FX Analytics" to provide anonymity for Mr. Wilson. They soon filed suits in Virginia, Florida, New York and several other states, according to people familiar with the matter, all of which remain under seal.

The Virginia and Florida filings alleged that BNY Mellon cherry-picked the least-favorable rates for pension funds. Using the whistleblower's information, the suit listed specific amounts of standing-instruction trades—$5.375 billion—that had been processed through a Pittsburgh desk in July 2009. The lawsuits referred to a "relator" who "possesses extensive knowledge and experience regarding (BNY Mellon's) bank offices, businesses and personnel, including personal contact with the employees and executives of BNY Mellon ... who have committed the alleged violations."

The whistleblower suits remained a secret until earlier this year. In January 2011, Virginia Attorney General Kenneth Cuccinelli II intervened and took control of the suit against BNY Mellon in a move that unsealed the 2009 FX Analytics complaint. Florida Attorney General Pamela Jo Bondi did the same.

Those moves were the first public indication that someone inside BNY Mellon was aiding litigation against the bank. Inside BNY Mellon, Mr. Wilson feared his role would be revealed. Friends and colleagues openly discussed who the insider might be.

However, Mr. Wilson was never confronted. Earlier this year he told his boss he was retiring. He moved from Pittsburgh to New England in July.

On Aug. 11, Virginia's Mr. Cuccinelli sued BNY Mellon, alleging the bank had given a fake currency-transaction price to Virginia funds on more than 73,000 trades. The complaint said the "relator" was "employed in the FX trading department at (BNY Mellon) in Pittsburgh" and that "the relator observed (BNY Mellon's) FX trading for its custodial clients and learned directly that the FX scheme described herein was orchestrated and demanded by the senior executive staff of the Bank."

Last week, New York's attorney general intervened and filed its own suit, and the Manhattan U.S. attorney's office also filed suit. Both lawsuits kept secret the role Mr. Wilson played.

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Personal Finance
Low Rates Hit Money-Market Funds

By Mary Pilon And Randall Smith
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English

Money-market mutual funds, those havens of safety for investors during tumultuous times, are facing their own pressures as interest rates continue to decline.

The funds, which historically aimed to provide higher yields than bank deposits without risk of losses, are waiving fees and consolidating—or closing their doors altogether. The drop Thursday on the 10-year Treasury to below 2% in intraday trading provided fresh bad news for the funds.

Money-market funds once were profit machines, collecting $13 billion in fees at their peak in 2008. But they have seen their revenues shrivel by 65% over the past three years as short-term interest rates have fallen to near zero.

The Federal Reserve's announcement last week that it would likely leave rates untouched for the next two years erased hopes for improvement anytime soon, say analysts.

Despite the continued interest-rate pressures, money-market funds have seen a surge of inflows recently as investors increasingly seek the safety of cash amid the market turmoil. Some $60 billion has gone into money funds this month, according to money-fund tracker Crane Data LLC.

Also, a recent announcement by Bank of New York Mellon Corp. that it might start charging customers with $50 million or more in their accounts to hold their cash could force others into money funds.

Still, any big inflows into money funds could be temporary, depending on the length of the market chaos, and with interest rates remaining low, would offer little relief for the industry, analysts say.

Whether the funds can withstand these pressures is an open question, says Sean Collins, senior economist with mutual-fund trade group Investment Company Institute.

Until U.S. policy makers dropped interest rates to rock-bottom levels starting in late 2008, investors used to think of the 1950s as a period of sustained low interest rates that preceded the inflationary era of the 1960s and 1970s, when some short-term interest rates approached 20%. "This makes the 1950s look like the 1970s," says Peter G. Crane, president of Crane Data.

The crunch has forced firms to waive fees on funds for certain investors, such as when the net yield of the fund after fees would be negative, consolidate, or close down funds altogether. Last month, a $485.9 million fund run by eBay Inc.'s PayPal electronic payment unit closed its doors. A $137 million fund run by Natixis SA was liquidated in February 2011.

A PayPal spokeswoman said that "due to market conditions, financial advantages of the money-market fund have diminished for our customers." A spokeswoman for Natixis said its fund was liquidated "because it was no longer a core offering within our product lineup."

The number of money-market funds in operation already has dropped to 652 at the end of 2010 from 805 at the end of 2007, according to data from ICI.

Some investors are finding alternatives to money-market funds. Mitchell Seldin, a retired auto-finance employee in Bayport, N.Y., said that last fall he removed all but $100,000 of the assets he had in money-market funds, then yielding less than 1%, and moved them into higher-yielding New York municipal bonds. He said of money funds: "They pay nothing."

The $2.6 trillion money-market-fund industry has struggled to regain its footing after the financial crisis.

The giant Reserve Primary Fund "broke the buck," or dipped below the $1 net asset value the funds seek to maintain, after Lehman Brothers Holdings Inc. filed for bankruptcy protection in 2008. That sparked a panic that eased only after the Fed promised to guarantee all money funds.

Regulators since have added rules that aim to prevent another run on the funds, from increasing credit quality of holdings and requiring funds to have more cash on hand to meet investor redemptions.

Money-market funds, around since the late 1970s, are an important cog in the overall liquidity of the financial system. They are big buyers of commercial paper and debt, especially European bank debt. Companies rely on them for short-term financing.

As the money fund industry searches for ways to remain profitable in the new world of low interest rates, they are being squeezed like never before.

Five years ago, the average after-fee yield on a money-market fund was just under 5%, according to Crane Data. Funds paid an average of more than 5.4% to investors, easily enough to justify the average expense level of 0.42%.

When the Fed began lowering short-term interest rates to stimulate the economy, margins began to shrink.

The gross yield generated by funds has fallen steadily—from 0.95% in February 2009 to 0.51% to a recent low of 0.22% in July.

Investors are beginning to bet against one big money-fund provider, publicly traded Federated Investors Inc. The short interest, or percentage of negative bets, on the company's shares has risen to 14%, from 5.9% in 2009, according to data from FactSet Research Systems.

Federated derives 45% of its revenue from money-market funds, according to its second quarter-earnings report. The firm cited the use of fee waivers and lower money-fund assets as part of a $13.1 million—or 5%—decrease in revenue from the first quarter of the year to the second.

A Federated spokeswoman declined to comment on the short interest.

J.P. Morgan Chase & Co., Fidelity Investments and State Street Corp. are also giving select waivers on money-market funds.

Even BlackRock Inc., which only has a sliver of its $3.7 trillion in assets under management in money-market funds, singled them out as decreasing fee revenue in its last earnings call. "This is an industry issue related to zero interest rates in the short end," said the firm's CEO, Laurence D. Fink.

"We've been living in a zero-interest rate-environment for so long," says Sue Hill, a portfolio manager with Federated.

"Rates are very, very difficult for money-market fund portfolio managers," says Robert Brown, who heads Fidelity's money-market funds. "It's the cost of doing business right now."

Anusha Shrivastava contributed to this article.

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Markets

Big Investors' Bank Bets Diverge

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Big investment funds were mixed on their approach to bank investments during the second quarter, with Wells Fargo & Co. and Bank of America Corp. among the companies whose stocks saw stark opposing bets.

In their filings on investment holdings as of June 30, Bruce Berkowitz's Fairholme Capital Management bolstered its high-profile stake in Bank of America Corp. while John Paulson's Paulson & Co. slashed its BofA holding. And while Warren Buffett's Berkshire Hathaway Inc. and Mr. Paulson added to their Wells Fargo holdings, George Soros's Soros Fund Management LLC fund all but bailed out.

Four times a year, many investors who manage more than $100 million are required to disclose holdings in certain types of securities, including stocks, within 45 days of the end of a given quarter.

The so-called 13F disclosures with the Securities and Exchange Commission give the public a relatively fresh look inside the portfolios of major money managers.

Fairholme Capital

The mutual-fund management company run by Mr. Berkowitz, added to its large holding of Bank of America, though reduced its stake in investment bank Morgan Stanley.

The BofA stake of 99.65 million shares was increased by seven million shares and was worth $1.09 billion at the end of June. It would be valued about $762.3 million as of Monday's closing prices.

Mr. Berkowitz last week had invited all "skeptics" of BofA to join him on a conference call with the bank's Chief Executive Brian Moynihan where the investor pledged to ask the toughest questions submitted. The stock, which ended last week down 11%, climbed 7.9% Monday but is down 42% this year.

Meanwhile, the fund reported owning 12 million shares of Morgan Stanley, valued at $275.3 million as of June 30, down from roughly 39 million shares as of March 31. The holding would be worth about $215 million as of the end of Monday's trading.

Fairholme has been a stockholder in Morgan Stanley for more than a decade, according to FactSet, owning 4,680 shares back in March 1999.

David Benoit

and Brett Philbin

Paulson & Co.

Billionaire investor Mr. Paulson slashed his holdings in Bank of America and some big gold stakes, but built his holdings in Wells Fargo and Capital One Financial Corp.

Mr. Paulson, one of the biggest names in hedge funds and head of Paulson & Co., has faced a rough month of July, as his shares in financial companies have been battered amid a broad market selloff. According to the filing, Mr. Paulson was active ahead of July in moving around his financial stocks, where he has been among the loudest boosters.

His stake in Bank of America, the nation's biggest bank by assets, plunged to 60.4 million shares at the end of June from 123.6 million shares at the end of March. The Wall Street Journal had reported last month that Mr. Paulson had sold some shares but was again looking to buy.

Still, Mr. Paulson, who gained prominence with his bet against the housing bubble, kept significant investments in financials in the most recent filing, despite paring the Bank of America stake and reducing his holdings in Citigroup Inc. to 33.5 million shares from the equivalent of 41.3 million shares.

Mr. Paulson boosted his investment on Wells Fargo to 33.6 million shares, up 20.5 million shares. His investment in Wells would be valued at $838.2 million as of the end of Monday trading. His holdings in Capital One rose to 21.1 million shares, up by 3.1 million shares, and would be worth $957.9 million.

But Mr. Paulson also appeared to pull back from another bullish bet on gold holdings, paring his stakes in gold companies AngloGold Ashanti Ltd. and Gold Fields Ltd. and selling Kinross Gold Corp. He had held 19 million shares of Kinross last quarter, according to the filings.

Mr. Paulson did report buying a new stake in media company News Corp. of 10.4 million shares, which would be worth about $176 million as of Monday's closing. News Corp is the owner of the Journal.

David Benoit

Berkshire Hathaway

Mr. Buffett's company disclosed a $50.8 million investment in discount retail chain Dollar General Corp. Observers say the purchase likely was made by Todd Combs, the new investment manager tapped to manage a portfolio of about $2 billion to $3 billion as the company prepares for the day the 80-year-old Mr. Buffett will no longer run Berkshire.

The company also showed increased stakes in MasterCard Inc. and Wells Fargo and reduced its holding of Kraft Inc.

An earlier filing revealed Berkshire bought $3.62 billion of equity securities in the second quarter, and sold $200 million—though the earlier disclosure didn't name the companies. That means the new shares revealed in Monday's filing, valued at less than $400 million as of June 30 in total, represent a fraction of the purchases the company made in the quarter.

Berkshire said it had omitted some information on its holdings in the filing, an action some investment managers are permitted to take by the Securities and Exchange Commission when they are building or eliminating a position. Such "confidential treatment" prevents others from piggy-backing on their investment ideas. The filing also excludes Berkshire's overseas holdings.

The omitted purchases could be concentrated on one firm or spread out over multiple companies, but Mr. Buffett has expressed a willingness this year to spend Berkshire's cash on a major acquisition. "Our elephant gun has been reloaded, and my trigger finger is itchy," he wrote in February in his annual shareholder letter.

Investors had also assumed MasterCard was a Combs pick when it was first disclosed three months ago. Berkshire's MasterCard stake rose by 88% to 405,000 shares in the quarter. The holding was valued at $122 million as of June 30.

Both holdings are far smaller than a typical Berkshire investment, and Mr. Buffett said in an interview with Bloomberg Television on July 8 that Mr. Combs had made two investments so far. Of the MasterCard stake, he said "I didn't buy it," all but confirming it was Mr. Combs's pick.

The Wells Fargo stake, in contrast, rose 2.8% to about 350 million shares. The holding, one of the largest positions in Berkshire's equity portfolio, was valued at nearly $10 billion as of June 30.

The Kraft holding fell about 5% to roughly 100 million shares valued at about $3.5 billion.

News about Berkshire's stock picks can move the shares of the newly disclosed holdings as money managers look to mimic the investment success of the "Oracle of Omaha." However, Mr. Buffett has long warned not all the moves in the portfolio are his.

Berkshire also showed it held shares of insurance-services company Verisk Analytics Inc. While it was the first time the holding was revealed in the quarterly filing, Berkshire had been an investor in the firm, along with several insurance companies, before Verisk's initial public offering in 2009.

Erik Holm

Soros Fund Management

Mr. Soros's hedge fund reported lower stakes in big banks Citigroup and Wells Fargo and slashed its ownership in Monsanto Co., a former top holding.

Mr. Soros decreased his holdings of Citigroup by nearly 2.9 million shares to 64,600 at the end of the second quarter. The stake is now valued at $2.7 million. Citi exercised a 1-to-10 reverse stock split in May. The fund also cut its stake in Wells Fargo by 3.4 million shares to 77,700, valued at $2.2 million at June 30.

Mr. Soros reduced his stake in Monsanto by 2.6 million shares to 79,400. The position is now valued at $5.8 million.

Among notable omissions this quarter, Mr. Soros reported selling Internet giant Google Inc. during the period. The fund had previously disclosed owning 116,208 shares of Google and call options on 22,500 shares of the company, as of the end of March.

The overall value of Soros's stock holdings fell to $7.1 billion at the end of the second quarter, down from $8.4 billion as of March 31.

In purchases during the quarter, Mr. Soros reported a higher stake in Motorola Solutions Inc., a company that split with Motorola Mobility Holdings Inc. —the target of a $12.5 billion bid by Google announced earlier Monday—at the beginning of the year. Mr. Soros's ownership in Motorola Solutions climbed to 5.7 million shares valued at $261 million as of June 30. The position is now the fund's fourth-largest holding. The fund also disclosed call options on 357,300 shares of Motorola Solutions.

In another sign of his reported retreat from gold, Mr. Soros reported selling mining company NovaGold Resources Inc. The fund already had been paring back its stake in the precious metal in the first quarter.

Mr. Soros, who once dubbed gold "the ultimate asset bubble," was one of several big money managers who loaded up on gold, silver and other metals over the past two years amid weakness in the U.S. dollar. In May, however, the Journal reported that Mr. Soros and some other leading investment firms sold gold and other metal stocks.

Monday's report from Mr. Soros comes nearly a month after reports that he decided to turn his hedge fund into a $24.5 billion "family office," in a move that allows it to avoid a new level of regulatory oversight facing many hedge funds. Mr. Soros told clients that his firm, Soros Fund Management LLC, will no longer manage outside investors' money.

Brett Philbin

Trian Fund Management

Investor Nelson Peltz's Trian Fund Management LP reported increased stakes in Kraft Foods and State Street Corp., plus a new stake in Domino's Pizza Inc.

Trian reported holding 17,311,152 shares of Kraft, up from 12,176,355 reported at the end of March. The State Street stake increased to 6,143,366 shares from 2,325,000.

Trian increased or took new stakes in several companies, including a 6 million share stake in Domino's. It also decreased or reported no holdings in other companies, including no stake reported for MGM Resorts International, in which Trian had held 400,000 shares at the end of March.

Other new stakes that showed up in the quarter ended in June include CoreLogic Inc. at 1,346,343 shares and Consol Energy Inc. at 699,700 shares.

Since the end of the second quarter, Trian has increased its stake in Legg Mason Inc. by 24%, or 2.7 million shares. That additional stake wasn't reflected in the filing, which reports Trian's holdings at the end of June of 11,257,370 shares.

Mr. Peltz swapped a previous investment in oil for one in gold in the quarter. He reported no holdings of the U.S. Oil Fund exchanged-traded fund, in which he held 30,000 shares at the end of March. But he did report a new stake 13,600 share stake in the SPDR Gold Trust.

Liz Moyer

Icahn Capital

Billionaire investor Carl Icahn reported a new stake in Vector Group Ltd., which makes Liggett and other cigarettes and owns the prominent New York-area real estate brokerage Douglas Elliman Realty LLC.

Mr. Icahn also reported a passive 7.6% stake in the energy company El Paso Corp. and appeared to exit from positions in a number of pharmaceutical and energy companies, as well as toy maker Mattel Corp.

Mr. Icahn, who omitted some information on his holdings as allowable under SEC regulations, also appeared to sell one of his largest holdings, drug maker Biogen Idec Inc. As recently as June 22, Mr. Icahn reported owning 8.2 million Biogen shares valued at nearly $750 million.

Icahn funds owned about 14 million shares of Vector Group, making it the largest shareholder in the Miami-based company.

The filings indicated Icahn-controlled funds sold their prior stakes in a number of companies, including: biotech company Amgen Inc.; biopharmaceutical company Regeneron Pharmaceuticals Inc.; and Cyberonics Inc., which makes implantable devices to treat epilepsy.

Mr. Icahn also no longer reported stakes in power company NRG Energy Inc., oil and natural gas producer Chesapeake Energy Corp. and natural gas company Southern Union Co.

Paul Ziobro

Harbinger Holdings

Philip Falcone's fund firm reported more shares of energy companies than it previously had in its portfolio, while also saying it no longer had stakes in a major exchange-traded fund that tracks gold.

The New York-based fund also said it no longer held shares in New York Times Co.

Harbinger, which gained fame for betting against subprime-backed mortgage bonds, reported an increased exposure to energy companies. In particular, the fund said it had 150,000 shares of petroleum refiner CVR Energy Inc.and 250,000 shares of Southern Union.

Harbinger also said it now had a position in BlackBerry smartphone maker Research In Motion Ltd. During the second quarter, RIM sank to recent lows as it struggled to keep its smartphones relevant amid continued popularity of Apple Inc.'s iPhone and devices running Google's Android operating system.

Harbinger also no longer reported holdings in SPDR Gold Trust, which has been bouncing near all-time highs as investors continue to look at the precious metal as a hedge against economic uncertainties both in the U.S. and abroad.

The value of Harbinger's reported equity assets rose more than 87% from the previous quarter to nearly $2 billion.

Ian Sherr

Greenlight Capital

Hedge-fund manager David Einhorn reported holdings Monday that signal his enduring faith in Microsoft Corp., even as he has shed a stake in Microsoft partner Yahoo Inc.

Mr. Einhorn's Greenlight Capital Inc. reported a stake in Microsoft that totaled roughly 14.8 million shares as of June 30—compared to about 9.1 million shares at the end of the prior quarter. Shares of Microsoft have fallen 8.6% in the year so far.

Mr. Einhorn has expressed his appreciation for Microsoft in the past, telling an audience at an investment conference in May that the Redmond, Wash., company is not receiving proper attention from investors. Microsoft has continued to pull in significant profits from its traditional Windows and Office software businesses, even as it shows a loss for its newer online services unit.

However, Mr. Einhorn recently shed his stake in Microsoft partner Yahoo. Microsoft is powering the search and advertising results on Yahoo websites, in a revenue-sharing arrangement. Mr. Einhorn's disclosure to investors that he'd dropped his Yahoo stake was reported last month. Greenlight Capital had reported holding 8.5 million shares of Yahoo for the period ended March 31.

Mr. Einhorn also on Monday reported a larger stake in Microsoft rival Apple. Greenlight Capital reported having roughly 1.1 million shares of Apple as of June 30, compared to a holding of 837,500 shares at the end of the prior period.

Mr. Einhorn appears to have placed another bet on consumer spending with Best Buy Inc. Greenlight Capital reported holding roughly 6.9 million shares of the electronics retailer as of June 30, compared to about 6 million shares at the end of the prior period.

John Letzing

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THE WALL STREET JOURNAL.
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Two States Go After Big Bank On Forex

By Tom McGinty and Carrick Mollenkamp
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12 August 2011
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English

The legal stakes are rising for Bank of New York Mellon Corp. in a widening controversy over the way it prices currency trades for pension funds and other big clients.

On Thursday, attorneys general in Virginia and Florida filed civil suits against BNY Mellon alleging that the bank cheated pension funds in those states by choosing improper prices for currency trades the bank processed for the funds. The Virginia lawsuit, filed in a Fairfax, Va., state court, cites internal bank emails allegedly showing that senior bank officials knew about, and endorsed, a currency-trading method that hurt state pensioners.

The complaint cites what it describes as a 2008 email from a senior BNY Mellon banker, Jorge Rodriguez, warning his colleagues that if the bank was required to provide "full transparency" to its clients, the clients' "ability to carefully monitor each and every trade at the time of execution" would eat into profits by reducing the bank's "margins dramatically."

The bank strongly denies the allegations of wrongdoing. A BNY Mellon spokesman said the firm treats clients fairly. He declined to detail specifically how the bank assigns currency prices to its clients and said the bank will defend itself against litigation and expects to win "on the facts and the law."

Separately, a Wall Street Journal examination of almost four years of currency-trading data for two U.S. pension funds in California and Massachusetts indicates that BNY Mellon often gave both funds exactly the same exchange rates.

According to the Journal analysis, the rates BNY Mellon gave the two funds often were at or near the less favorable ends of the daily trading range.

The issues are particularly significant during heightened financial-market volatility. An internal 2008 BNY Mellon document reviewed by the Journal said large currency-price swings help the bank's revenue because they allow traders to "capture greater trading gains" when executing currency trades for institutional clients.

In a statement Thursday, a BNY Mellon spokesman said, "The lawsuits filed by the Virginia and Florida Attorneys General are unwarranted and reflect a flawed understanding of foreign currency markets." The spokesman said Mr. Rodriguez wasn't available for comment.

The recent developments come amid growing controversy over whether banks including BNY Mellon and State Street Corp. -- which offer specialized securities-handling and trade-processing services to institutional investors -- profited by providing pension-fund clients with unfavorable currency rates.

A whistleblower group has filed civil suits against BNY Mellon and State Street in California, Virginia and Florida, alleging the banks unfairly priced currency trades for their clients, pension funds that thousands of teachers, police, firemen and retirees rely upon.

Those lawsuits are based in part on information provided by whistleblowers within the two banks.

Authorities from the Justice Department and the Securities and Exchange Commission are investigating the allegations, according to a State Street filing and people familiar with the matter.

A State Street spokeswoman said it will defend itself in court and that it has acted properly.

Virginia's attorney general, Kenneth Cuccinelli II, alleges BNY Mellon didn't trade for its pension-fund clients at the moment the clients needed to exchange money.

Instead, a bank transaction desk waited until the end of the day to choose a price for the client, according to the suit. The delay allowed the bank to "determine the point when the actual range of the day was widest, thus offering the bank the greatest possible margin," the complaint says.

In the Florida suit, filed in Leon County court, state Attorney General Pamela Jo Bondi also alleged the bank gave special treatment to a client who were believed to be closely watching how BNY Mellon priced trades.

The Journal's separate analysis examined currency trades by two major pension funds, the Los Angeles County Employees Retirement Association and the Massachusetts Pension Reserves Investment Management board. The confidential trades were obtained through open-records requests to the funds.

BNY Mellon provided the pension funds with what are known as "custodial" and back-office financial services. These services include trading currencies on the pension funds' behalf as the funds buy or sell stocks and other investments abroad.

The Journal compared trades by the two funds that occurred on the same day and included U.S. dollars on one side of the trade and the Australian dollar, euro, pound or yen on the other. There were about 3,000 such overlapping trades during the period examined, from January 2007 though September 2010.

About 76% of the time that the two funds traded the same currencies on the same days, the pricing BNY Mellon provided the funds was identical out to the fourth decimal point. The Journal analysis shows that when pension-fund clients gave BNY Mellon leeway to trade, the bank often assigned them the same prices.

At the heart of the issue is what are known as "standing instruction" trades: A pension fund empowers its bank to trade currencies on its behalf rather than negotiating the trades itself.

A BNY Mellon spokesman said it's "typical for standing-instruction customers to receive the same pricing" on a particular pair of currencies. "The price assigned reflects the risk we assume and services we deliver."

BNY Mellon said it provides clients a guaranteed range for currency trades each morning and that its customers can opt out if they don't like the price. The bank discloses the price assigned to the client the next day.

BNY Mellon said it typically handles small currency exchanges for clients that would have had difficulty getting better rates elsewhere. (Small trades would likely be those under $1 million or so.) The bank said large trades make up a small proportion of such standing-instruction trades.

The bank said its standing-instruction clients receive pricing within the "interbank trading range," the market where global banks trade currencies. "To call these rates 'least favorable' is factually incorrect and misleading," a spokesman said.

The Journal analysis of 3,012 trades BNY Mellon executed on the same dates in the same currencies for the $33 billion Los Angeles fund and the $50.3 billion Massachusetts pension system shows that small and large trades often received the same treatment.

For instance, on Sept. 6, 2007, both funds used BNY Mellon to exchange British pounds for U.S. dollars. During the day, some traders, such as banks, received as much as $2.0271 for each pound exchanged for dollars. The two pension-fund clients were given a rate of $2.0162 per pound, close to the lowest price, $2.0139.

The two funds were trading vastly different sums of money that day. The Los Angeles fund's trading totaled $8,600, that day, while the Massachusetts fund's trades totaled $62.9 million.

An analysis of the Los Angeles fund's trades showed that 48% of the currency trades between 2007 and 2010 were within 10% of each day's trading range that was least favorable to the fund.

For the same time period, the Massachusetts data showed that 50% of the trades were priced within 10% of the least favorable range.

Of a total of 5,721 trades analyzed by the Journal, the funds traded the same currencies on the same days 3,012 times. They received the exact same price for 2,299 of those trades, or 76% of the time.

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THE WALL STREET JOURNAL.

Markets
Florida, Virginia Sue BNY Mellon

By Carrick Mollenkamp
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English

Attorneys general in Florida and Virginia sued Bank of New York Mellon Corp. on Thursday, alleging that one of the world's biggest custody banks improperly charged state and local pension funds for currency transactions.

Virginia Attorney General Kenneth Cuccinelli II filed his complaint in Fairfax County. Florida Attorney General Pamela Jo Bondi filed her lawsuit in Leon County. Earlier this year, both attorneys general took control of complaints filed by a whistleblower legal group and then had the option of filing their own complaints, seeking a settlement, or not pursuing the litigation.

The two state prosecutors join California in pursuing litigation. In 2009, then-California Attorney General Jerry Brown sued State Street Corp., alleging the custody bank improperly priced foreign exchange for California funds. A State Street spokeswoman denies the allegation and will fight the claim in court.

In a statement, Ms. Bondi said, "Every penny that state and local employees entrust to Florida's pension fund is hard-earned, and we will not allow Floridians' money to be lost due to fraudulent activity."

Mr. Cuccinelli said in a statement, "Based on the information the whistleblower provided and the information developed using the investigatory tools authorized in the Fraud Against Taxpayers Act, I determined it was prudent to intervene in the case and protect the interests of the retirement fund beneficiaries."

In a statement, BNY Mellon said, "The lawsuits filed by the Virginia and Florida Attorneys General are unwarranted and reflect a flawed understanding of foreign currency markets. We will fight these claims in court and are confident we will prevail. We value our client relationships and are always prepared to respond to our clients' questions about the pricing of our services. While our first choice is always an amicable resolution, we refuse to be coerced into paying for and admitting to wrongdoing where none exists."

Write to Carrick Mollenkamp at carrick.mollenkamp@wsj.com

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THE WALL STREET JOURNAL.

Business

S&P Cut Ripples Across Businesses

By Leslie Scism, Mary Pilon and Alan Zibel
929 words
9 August 2011
The Wall Street Journal Online
WSJO
English

The ripple effects of Standard & Poor's unprecedented downgrade of U.S. debt spread through the financial system on Monday with some of the nation's biggest life insurers, securities clearinghouses and investment funds losing their triple-A ratings.

Fannie Mae and Freddie Mac, the government-controlled mortgage-finance giants, were also downgraded as large swathes of the financial world adjusted to a new era in which the U.S. no longer commands the highest rating from all the major ratings firms.

The widely anticipated downgrades—one notch down to double-A-plus with a negative outlook for many of the affected entities—were a direct result of S&P's cut of the U.S. sovereign-debt rating on Friday. Last month, S&P had put scores of companies and funds on negative watch, signaling the threat of a future downgrade, after applying that view to the U.S.; under S&P's criteria, a nation's rating constrains the financial-strength ratings on insurers and some other entities.

The downgrades sting the pride of these companies and the investment funds, but it isn't clear if consumers will suffer, as the entities still are very highly rated. And despite fears that rates paid by consumers on home loans would soar, S&P's downgrade of the U.S. government had minimal immediate impact on mortgage rates, which have been near historic lows. Demand for mortgage-backed securities cooled only slightly Monday, despite the downgrade.

The five insurers to lose triple-A status are Knights of Columbus, New York Life Insurance Co., Northwestern Mutual Life Insurance Co., Teachers Insurance & Annuity Association and United Services Automobile Association.

S&P also revised the outlook to negative, from stable, on five double-A-plus insurance groups:. Warren Buffett's Berkshire Hathaway Inc., Assured Guaranty Corp., Guardian Life Insurance Co. of America, Massachusetts Mutual Life Insurance Co. and Western & Southern Financial Group Inc.

In recent interviews, many of the companies said their financial health justified continued triple-A ratings and that they remain confident in the strength of their business models. In taking action on the 10 insurance groups, S&P said its views of the companies' fundamental credit characteristics were unchanged but noted the companies' businesses and assets are highly concentrated in the U.S.

A New York Life spokesman said, "We disagree with S&P's view that AAA-rated insurers should be adjusted in lockstep with the U.S. Treasury." A Knights of Columbus spokesman said S&P's downgrade has "nothing to do with us; everything to do with Washington."

In downgrading 73 funds, including bond funds, exchange-traded funds and hedge funds, S&P noted that the funds generally had exposures of 50% or more, directly or indirectly to the U.S. Treasury and government agency securities.

The list of 73 shows the wide array of investors affected by the loss of the U.S.'s triple-A rating, with funds from BlackRock Inc., Federated Investors Inc., Franklin Resources Inc., State Street Corp. and Goldman Sachs Group Inc.'s asset-management arm.

Local-government investment pools, such as the City of Los Angeles General Pool, the Georgia Extended Asset Pool and the Palm Beach County Investment Portfolio, also were downgraded.

S&P lowered ratings on clearing facilities run by the Depository Trust & Clearing Corp. and OCC, previously known as the Options Clearing Corp., to double-A-plus with negative outlooks. The clearing firms hold vast quantities of U.S. Treasurys as collateral against outstanding trades. The OCC handles all U.S. stock-options trade, with the DTCC units backing up trading in U.S.-listed shares and government securities.

S&P said the downgrades aren't the result of any company-specific event, and noted that its view hasn't changed of the fundamental soundness of their depository or clearing operations.

"This rating change will have no negative impact on OCC's operations or our ability to meet our obligations to OCC's clearing members," said Wayne Luthringshausen, chairman and chief executive of OCC, in a statement. Representatives for the DTCC said the company remains "as financially strong as before this announcement."

In downgrading Fannie Mae, Freddie Mac and several other U.S. government entities, S&P cited their dependence on federal support. Included in the downgrade were the senior issue ratings on debt issued by Fannie and Freddie, the giant mortgage-finance firms.

Edward DeMarco, acting director of the companies' regulator, the Federal Housing Finance Agency, said the government's commitment to support the two mortgage giants "remains unaffected by the Standard and Poor's action."

Ten of the 12 Federal Home Loan Banks, which also provide funding for home loans, also received downgrades. Two of the banks already had the lower double-A-plus credit rating.

Meanwhile, some Democrats began lashing out at S&P, siding with the Obama administration, which over the weekend had criticized S&P's decision. Senate Banking Committee Chairman Tim Johnson (D, S.D.) in a statement called the downgrade an "irresponsible move" that may "have spillover effects" such as higher borrowing costs for home buyers, credit-card holders, car buyers, and state and local governments.

Jacob Bunge, Tess Stynes and Melodie Warner contributed to this article.

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S&P Cut Ripples Across Businesses

By Leslie Scism, Mary Pilon and Alan Zibel
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Fannie Mae and Freddie Mac, the government-controlled mortgage-finance giants, also were downgraded as large swaths of the financial world adjusted to a new era in which the U.S. no longer commands the highest rating from all the major ratings firms.

The widely anticipated downgrades -- one notch down to double-A-plus with a negative outlook for many of the affected entities -- were a direct result of S&P's cut of the U.S. sovereign-debt rating on Friday. Last month, S&P had put scores of companies and funds on negative watch, signaling the threat of a future downgrade, after applying that view to the U.S.; under S&P's criteria, a nation's rating constrains the financial-strength ratings on insurers and some other entities.

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THE WALL STREET JOURNAL.

New York

New York's Top Cop Jumps Into Fray

By Carrick Mollenkamp
883 words
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New York Attorney General Eric Schneiderman is poised to take the lead in inquiries by state officials into whether some banks properly charged state and local pension funds for thousands of currency transactions over the past decade.

The move by Mr. Schneiderman, who has the option of wielding a powerful state law called the Martin Act that effectively lets him cross state lines, could lead a nationwide lawsuit on behalf of pension funds in New York and across the country, according to people familiar with the situation. Alternatively, he could seek a settlement on behalf of funds nationwide.

The attorney general is investigating whether New York pension funds were charged properly for foreign-exchange transactions by Bank of New York Mellon Corp., these people said.

State officials from Virginia, Florida, Massachusetts, North Carolina, Ohio, Oklahoma and California are conducting inquiries or pursuing litigation into whether state and local pension funds were fairly charged for currency transactions by BNY Mellon and State Street Corp. of Boston. The Securities and Exchange Commission and Justice Department also are conducting inquiries, according to securities filings.

The probes were sparked by a whistleblower group that alleged in lawsuits in Virginia, Florida and California that BNY Mellon and State Street shortchanged public pension funds. The group includes financial-fraud investigator Harry Markopolos and attorneys in Boston and New York who represent parties to the lawsuits. Mr. Markopolos is a Boston-area investor who spent years warning the SEC that Bernard Madoff ran a Ponzi scheme.

At issue is whether these "custody" banks, which handle securities and back-office tasks for institutional investors, are overcharging public pension funds for trading in the $4 trillion-a-day foreign-exchange market.

BNY Mellon and State Street representatives have denied the allegations and said the banks intend to defend themselves against the claims. The representatives said the banks conducted business properly.

Mr. Schneiderman hasn't announced a public role in the New York currency probes. But people familiar with his office said a probe is under way.

Unlike officials in other states, Mr. Schneiderman can use the Martin Act, a 1921 law that allows prosecutors to pursue securities fraud without requiring prosecutors to prove intent to defraud.

The law gained prominence when former New York Attorney General Eliot Spitzer used it to pursue wrongdoing on Wall Street. The act has been used to prosecute Wall Street firms for securities manipulation, misleading stock research on Wall Street and improper allocation of initial public offerings of stock.

Now, Mr. Schneiderman is likely to use the law in conjunction with a revamped state false-claims act in investigating BNY Mellon over the foreign-exchange trades, according to people familiar with the situation. Using the Martin Act, the attorney general potentially could sue on behalf of funds in other states, the people said.

The probe is one of several inquiries Mr. Schneiderman has pursued since taking over as attorney general in January, after his predecessor, Andrew Cuomo, was elected governor in November. He is examining whether the life-insurance industry has adequately ensured payouts on policies of some deceased customers.

Separately, Mr. Schneiderman is examining how mortgages were packaged into securities.

State inquiries into foreign-exchange trading on behalf of state pension funds date to 2009 when then-California Attorney General Jerry Brown announced a lawsuit against State Street. This year, attorneys general in Virginia and Florida took control of whistleblower complaints filed in Virginia and Florida.

On Tuesday, BNY Mellon was expected to meet with Virginia officials in a mediation meeting that could lead to a settlement, according to people familiar with the situation. A spokesman for the Virginia attorney general said an update won't be provided until at least Aug. 11, the deadline for the Virginia attorney general to file his own complaint.

The BNY Mellon spokesman said, "We have been in conversations with several state AGs about the FX issue and are committed to resolving misunderstandings they have about our FX program. We believe very strongly that we treat clients fairly and are always responsive to concerns. If we are unable to resolve our discussions with the AGs constructively, we will defend ourselves aggressively in court and are confident that we will prevail on the facts and the law."

An inquiry by the New York attorney general's office would include a new department called the Taxpayer Protection Bureau along with potentially other divisions, said people familiar with the situation. Mr. Schneiderman, a former state senator and corporate attorney, set up the bureau in January.

The bureau's goal is to use a revamped state false-claims law, one Mr. Schneiderman helped pass while in the New York Senate, to investigate fraudulent claims for government money.

At a legal conference at New York University in June, lawyers working for the attorney general described in general how they planned to work with whistleblowers in pursuing fraud against New York taxpayers.

The lawyers didn't specifically discuss a foreign-exchange inquiry.

Randall Fox, chief of the new bureau, said one area his unit planned to probe was whether state pension funds had been defrauded. A speaker at the conference was Mr. Markopolos.

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New York's Top Cop Jumps Into Fray

By Carrick Mollenkamp
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Unlike officials in other states, Mr. Schneiderman can use the Martin Act, a 1921 law that allows prosecutors to pursue securities fraud without requiring prosecutors to prove intent to defraud.

The law gained prominence when former New York Attorney General Eliot Spitzer used it to pursue wrongdoing on Wall Street. The act has been used to prosecute Wall Street firms for securities manipulation, misleading stock research on Wall Street and improper allocation of initial public offerings of stock.

Now, Mr. Schneiderman is likely to use the law in conjunction with a revamped state false-claims act in investigating BNY Mellon over the foreign-exchange trades, according to people familiar with the situation. Using the Martin Act, the attorney general potentially could sue on behalf of funds in other states, the people said.

The probe is one of several inquiries Mr. Schneiderman has pursued since taking over as attorney general in January, after his predecessor, Andrew Cuomo, was elected governor in November. He is examining whether the life-insurance industry has adequately ensured payouts on policies of some deceased customers.

Separately, Mr. Schneiderman is examining how mortgages were packaged into securities.

State inquiries into foreign-exchange trading on behalf of state pension funds date to 2009 when then-California Attorney General Jerry Brown announced a lawsuit against State Street. This year, attorneys general in Virginia and Florida took control of whistleblower complaints filed in Virginia and Florida.

On Tuesday, BNY Mellon was expected to meet with Virginia officials in a mediation meeting that could lead to a settlement, according to people familiar with the situation. A spokesman for the Virginia attorney general said an update won't be provided until at least Aug. 11, the deadline for the Virginia attorney general to file his own complaint.

The BNY Mellon spokesman said, "We have been in conversations with several state AGs about the FX issue and are committed to resolving misunderstandings they have about our FX program. We believe very strongly that we treat clients fairly and are always responsive to concerns. If we are unable to resolve our discussions with the AGs constructively, we will defend ourselves aggressively in court and are confident that we will prevail on the facts and the law."

An inquiry by the New York attorney general's office would include a new department called the Taxpayer Protection Bureau along with potentially other divisions, said people familiar with the situation.

Mr. Schneiderman, a former state senator and corporate attorney, set up the bureau in January.

The bureau's goal is to use a revamped state false-claims law, one Mr. Schneiderman helped pass while in the New York Senate, to investigate fraudulent claims for government money.

At a legal conference at New York University in June, lawyers working for the attorney general described in general how they planned to work with whistleblowers in pursuing fraud against New York taxpayers.

The lawyers didn't specifically discuss a foreign-exchange inquiry.

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THE WALL STREET JOURNAL.

Business
Northern Trust Profit Falls 24%

By Mia Lamar
241 words
20 July 2011
08:14 AM
The Wall Street Journal Online
WSJO
English

Northern Trust Corp.'s second-quarter profit fell 24% as the company's top line took a hit from a 30% drop in foreign-exchange trading income.

Northern Trust, which provides investment management and other services to affluent people and large institutions, has in recent quarters faced challenges boosting its bottom line as interest rates remain historically low. In the latest period, interest income climbed 5.7%.

Tuesday, rival State Street Corp. noted that a slower recovery and low interest-rate environment in the U.S. pose short-term challenges for its business.

Northern Trust reported a first-quarter profit of $152 million, or 62 cents a share, down from $199.6 million, or 82 cents a share, a year earlier. The current period included an 8 cent per-share impact on restructuring and other expenses, while the prior-year period included a 4 cent per-share benefit.

Total revenue slipped 2% to $944.8 million. Analysts polled by Thomson Reuters recently forecast a per-share profit of 69 cents on $948 million in revenue.

Assets under custody rose 24% to $4.42 trillion while assets under management rose 13% to $684.1 billion.

Provision for credit losses was $10 million, down from $50 million a year earlier. Net charge-offs, or loans that lenders don't expect to collect, were $15 million, also down from $38.3 million a year earlier.

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THE WALL STREET JOURNAL.

Business
BNY Mellon, State Street Beat Earnings Estimates

By Melodie Warner And Mia Lamar
545 words
20 July 2011
The Wall Street Journal Online
WSJO
English

Trust banks Bank of New York Mellon Corp. and State Street Corp. reported solid second-quarter earnings amid higher fee revenue, beating Wall Street estimates.

Such banks act as custodians and servicers for corporations and Wall Street, with results tied heavily to market actions.

The Securities and Exchange Commission and other law-enforcement agencies are investigating allegations of improper foreign-exchange trading at State Street and BNY Mellon. The banks have denied the allegations and said they intend to defend themselves.

BNY Mellon

The New York-based bank's second-quarter earnings rose 12% as the company saw increased fee and net interest revenue.

The money manager and securities adviser, formed in 2007 when Bank of New York acquired Mellon Financial Corp., has seen its bottom line improve in recent quarters as fee revenue has rebounded and stock-market gains have helped lift its assets under management to record levels. But low interest rates have weighed on its results.

BNY Mellon reported a profit of $735 million, or 59 cents a share, up from $658 million, or 54 cents a share, a year earlier. For the year-earlier period, earnings from continuing operations were 55 cents. Revenue jumped 15% to $3.85 billion.

Analysts polled by Thomson Reuters had most recently forecast earnings of 55 cents on revenue of $3.68 billion.

Fee revenue rose 18% to $3.01 billion while net interest revenue edged up 1.2% to $731 million. Assets under management climbed 22% year-over-year to $1.274 trillion as of June 30, and were up 3.7% from the prior quarter.

There was no provision for credit losses in the latest period, compared with a reserve of $20 million a year earlier.

State Street

The Boston-based firm's second-quarter profit popped 19% as it reported strength on its top line, particularly in fee revenue.

Despite persistently low interest rates, State Street has posted improved core earnings in recent quarters, topping analyst expectations. Stifel Nicolaus analysts have called the company a favorite among rival trust banks, citing above-average exposure to equities and a larger position in servicing mutual funds and defined contribution plans.

State Street reported a profit of $513 million, or $1 a share, compared with a year-earlier profit of $432 million, or 87 cents a share. Excluding items such as discount accretion related to former conduit securities, earnings rose to 96 cents from 93 cents.

Revenue rose 8% to $2.49 billion, and was up 14% to $2.47 billion on an operating basis.

Analysts polled by Thomson Reuters recently estimated a per-share profit of 96 cents on $2.39 billion in operating revenue.

Assets under management ended the period at $2.12 trillion, up 15% from a year earlier and flat from the prior quarter.

Write to Melodie Warner at melodie.warner@dowjones.com

Corrections & Amplifications

Bank of New York Mellon's assets under management climbed 22% year over year to $1.274 trillion and were up 3.7% from the prior quarter. An earlier version of this article misstated the change as a 21% climb to $26.3 trillion and up 3% from the prior quarter.

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THE WALL STREET JOURNAL.
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Global Finance: Fees Give Lift to Trust Banks --- BNY Mellon, State Street Beat Profit Estimates; Low Interest Rates Still Hurt

By Melodie Warner and Mia Lamar
568 words
20 July 2011
The Wall Street Journal
J
C3
English

Corrections & Amplifications

Bank of New York Mellon Corp.'s assets under management climbed 22% year over year to $1.274 trillion and were up 3.7% in the second quarter from the prior quarter. A Money & Investing article on July 20 incorrectly described the change as a 21% climb to $26.3 trillion and up 3% from the prior quarter.

(WSJ August 3, 2011)

(END)

Trust banks Bank of New York Mellon Corp. and State Street Corp. reported solid second-quarter earnings amid higher fee revenue, beating Wall Street estimates.

Still, investors delivered a mixed response to the results, with BNY Mellon gaining nine cents, or 0.4%, to $24.73, and State Street shedding 93 cents, or 2.2%, to $42.02.

The trust banks, which act as custodians and servicers for corporations and Wall Street, have been in focus in recent months as the Securities and Exchange Commission and law-enforcement agencies have been probing allegations of improper foreign-exchange trading at State Street and BNY Mellon. The banks have denied the allegations and said they intend to defend themselves.

BNY Mellon reported a profit of $735 million, or 59 cents a share, up 12% from $658 million, or 54 cents a share, a year earlier. For the year-earlier period, earnings from continuing operations were 55 cents. Revenue jumped 15% to $3.85 billion.

Analysts polled by Thomson Reuters had forecast profit of 55 cents on revenue of $3.68 billion.

The money manager and securities adviser, formed in 2007 when Bank of New York acquired Mellon Financial Corp., has seen its bottom line improve in recent quarters as fee revenue has rebounded and stock-market gains have helped lift its assets under management to record levels. But low interest rates have weighed on its results.

Robert P. Kelly, BNY Mellon's chairman and chief executive, also pointed to cost pressures. "Expense growth remained high due in part to legal and regulatory costs. We are taking additional actions to reduce expenses," he said.

Fee revenue rose 18% to $3.01 billion while net interest revenue edged up 1.2% to $731 million. Assets under management climbed 21% year over year to $26.3 trillion and were up 3% from the prior quarter.

Meanwhile, Boston-based State Street reported a profit of $513 million, or $1 a share, up 19% from $432 million, or 87 cents a share, a year earlier. Excluding items such as discount accretion related to former conduit securities, earnings rose to 96 cents from 93 cents. Revenue rose 8% to $2.49 billion, and was up 14% to $2.47 billion on an operating basis.

Analysts polled by Thomson Reuters estimated a per-share profit of 96 cents on $2.39 billion in operating revenue.

Despite persistently low interest rates, State Street has posted improved core earnings in recent quarters, topping analyst expectations. Stifel Nicolaus analysts have called the company a favorite among rival trust banks, citing above-average exposure to stocks and a larger position in servicing mutual funds and defined-contribution plans.

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THE WALL STREET JOURNAL.

Business
In Turmoil, News Corp. Pivots on BSkyB

By
Dana Cimilluca
And Alistair MacDonald
963 words
12 July 2011
The Wall Street Journal Online
WSJO
English

LONDON—News Corp. took steps that will delay its proposed takeover of the BSkyB satellite-TV operation, as the company hopes to wait out the phone-hacking furor that continued to batter it Monday.

The moves, which could postpone approval of a deal for six months or more, exposes the takeover of British Sky Broadcasting Group PLC to new and unpredictable risks at a time when U.K. political support has largely deserted it. Both News Corp. BSkyB shares were sharply lower Monday.

The company appeared to have few other options as the deal became a lightning rod for public outcry over reporting tactics at News Corp.'s U.K. newspaper unit. Those include recent allegations that News Corp. journalists accessed the mobile-phone voice mails of politicians, celebrities and even crime victims.

BSkyB is seen as a key piece of News Corp.'s future, representing a steady, lucrative revenue stream as the company transitions away from its origins as a print newspaper company. News Corp. already owns a little under 40% of the company, and last year made a takeover bid for the remainder that could eventually be worth roughly $15 billion.

A delay could be helpful for News Corp., which is caught in a turmoil of daily disclosures and allegations. But shareholders are getting increasingly nervous, sending BSkyB shares down 7.6% earlier in the day Monday. The shares finished down 4.8%, to 714 pence ($11.46) in London. BSkyB shares have fallen 16% since the phone-hacking allegations began to undercut confidence that a deal would win regulatory approval. (News Corp. and BSkyB were waiting for regulatory approval before negotiating on price.)

Shares of News Corp., which also owns The Wall Street Journal, fell 7.6% in Monday Nasdaq trading to $15.48. They are off 14% over the last five trading days.

On Monday, News Corp. withdrew a prior agreement to spin off BSkyB's 24-hour Sky News channel, a procedural move that triggered a referral of the deal to the U.K.'s Competition Commission. That body will rule on whether the proposed deal would harm the number of voices in the U.K. media landscape. News Corp. had previously agreed to spin off Sky News in an effort to avoid a lengthy competition review.

With the change, the decision is out of the hands of the Department of Media, Culture and Sport, run by an elected official, Jeremy Hunt, and handed to an independent body.

The commission's review will last 24 weeks, and it could be extended for another eight weeks. An approval from the commission is far from guaranteed, and News Corp. could still ultimately be forced to agree to a Sky News spinoff. The commission would ultimately send a recommendation back to Mr. Hunt, who would make a final decision. By then, News Corp. hopes, some of the intense heat from the current scandal will have diminished.

Mr. Hunt on Monday sent a letter to communications-industry regulator Ofcom and the U.K.'s Office for Fair Trading "asking for further advice in light of the emerging events from the phone hacking scandal." Mr. Hunt, who had been expected to sign off on the deal as early as this week, following a lengthy review, already backed off that timetable last week, in light of new allegations in the long-running scandal.

Critics argued that the media company shouldn't be allowed to increase its presence in a U.K. media landscape where it already looms large. Pollsters YouGov found that 9% of voters surveyed think the deal should go ahead, 70% said it shouldn't.

Deputy Prime Minister Nick Clegg joined that chorus later Monday, saying News Corp. chairman and CEO Rupert Murdoch should "do the decent and sensible thing, and reconsider, think again, about your bid for BSkyB." He thus became the most senior member of the coalition government to come out against the bid.

Another wild card in the proceedings is Ofcom, the U.K. communications regulator that has jurisdiction over whether individuals at media companies are "fit and proper" to hold a media license, and has signaled in recent days that it is watching the case.

Bets were mixed on Wall Street as to whether the BskyB deal will get done. "A potential BSkyB/News Corp. merger no longer looks as certain as we thought it was a week ago," Citigroup analysts wrote in a research report Monday. But the same note also said that, "barring the most dramatic outcomes from the criminal investigations, we still see it as a matter of 'when' not 'if'."

Alex DeGroote, a media analyst at Panmure Gordon & Co., however, lowered the probability of a BSkyB deal getting done to 10% from 50%. "In other words, we believe the deal is all but dead," Mr. DeGroote said in a statement. Also on Monday, ratings agency Fitch said it would view a regulatory block of the attempted acquisition of BSkyB as "negative" for News Corp and Macquarie downgraded News Corp. to "underperform" due to the regulatory uncertainty.

The biggest shareholders in BSkyB are institutional investors, such as Capital Research & Management Co., which is BSkyB's biggest shareholder with just over a 9% stake. BlackRock Inc. is the second largest investor with almost a 4.6% stake, while Fidelity Investments and State Street Global Advisors are also among the top ten shareholders.

Hedge funds Taconic Capital Advisors and Perry Capital have a smaller presence, with ownership of almost 1.2% and about 1.1%, respectively.

Lilly Vitorovich

contributed to this article.

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THE WALL STREET JOURNAL.

Personal Finance
Investors' New Worry: Is There Greek Debt in My Money Fund?

By Mary Pilon
583 words
28 June 2011
The Wall Street Journal Online
WSJO
English

Recent news that money-market funds may be in trouble again has raised questions about these investments for the second time in three years.

Last week, lawmakers and regulators registered concerns about money-market funds' exposure to the European debt crisis. About half of the assets in the 10 largest U.S. prime money-market funds are invested in European bank debt, according to a report from Fitch Ratings.

Should Greece default on its obligations to those banks, as many fear it may do, regulators are concerned that $1.6 trillion in prime money-market funds will be in jeopardy.

For investors, the risk is that a fund could "break the buck"—that is, the net asset value of the fund could drop below $1 a share.

That is what happened in 2008 when, for the first time in 14 years, one large money-market fund was caught holding too much debt issued by Lehman Brothers Holdings Inc. Though the ultimate losses amounted to less than a penny on the dollar, that was too much for investors who expected never to post any losses on these holdings. Because the funds are so pervasive—companies use them as holding tanks for payroll funds, individuals use them as savings accounts with slightly better yields, brokerage houses use them to hold clients' uninvested funds—regulators stepped in with a series of measures to prop up the funds, the last of which expired in 2010.

The crisis in Europe isn't likely to require such extreme measures, experts say. And the turmoil thus far hasn't been as severe, says Deborah Cunningham, chief investment officer for taxable money-markets at Federated Investors Inc. While several French financial institutions in particular were hit by warnings of potential ratings downgrades last week, the warnings didn't apply to short-term debt. So while prime money-market funds offered by companies including Fidelity Investments and State Street Corp. may hold the debt of institutions such as BNP Paribas, Crédit Agricole SA and Société Générale SA, among other French banks, short-term holdings wouldn't be as risky as, say, directly holding shares of company stock.

Fidelity and State Street declined to comment on the individual holdings of their money-market funds.

And following the global financial crisis, money funds have been required to keep a pool of assets on hand that they could use to absorb losses in an emergency.

The problem is perception as much as reality. Though only one fund officially broke the buck in 2008, it caused a crisis for the whole industry. "It's the contagion effect that people are looking at," Ms. Cunningham says.

Money-market funds are required to report their holdings monthly, so concerned investors can check fund company websites, or through the Securities and Exchange Commission's website, sec.gov. Because the filings are monthly, it won't always be the most current information, says Robert Dubois, president of Trend Modus Capital Management LLC, of Kansas City, Mo., and the filings can be hard to understand. "There's just a shortage of meaningful information," he says.

He recommends an alternative: staying out of prime money-market funds entirely. He uses certificates of deposit or short-term U.S. Treasurys for clients instead; money-market funds that invest only in U.S. government debt are another option.

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THE WALL STREET JOURNAL.

Markets

Anatomy of a Market Meltdown

By Serena Ng And Carrick Mollenkamp
1,002 words
27 June 2011
The Wall Street Journal Online
WSJO
English

Going into 2011, battered mortgage bonds looked like a relatively safe bet for Wall Street. Prices of bonds underpinned by subprime home loans had recovered from the depths of the financial crisis, and mortgage defaults—while still high—were easier to predict.

For months, banks were able to profit from buying the bonds and selling them to investors as they rose in value. In late 2010, Boston custody bank State Street Corp. sold $11 billion in mortgage- and asset-backed securities to investment banks including Goldman Sachs Group Inc. that quickly sold most of them to investors, a sign of market demand for the securities.

In February, Credit Suisse AG chief executive Brady Dougan said the Swiss bank saw strong results from trading residential mortgage securities amid "what was a resilient environment for those products in 2010," according to a transcript of its fourth-quarter earnings call. Mr. Dougan also said the mortgage business should continue to benefit in 2011 from investors' desire for higher-yielding investments.Wall Street's confidence grew in March when American International Group Inc. publicly offered to buy back a $30 billion portfolio of mostly subprime mortgage bonds from the Federal Reserve Bank of New York, which had held them since the crisis. The bailed-out insurer offered to pay $15.7 billion cash, or an average of 53 cents on the dollar, for the bonds.

AIG's move prompted several banks, including Credit Suisse and Barclays Capital, to consider assembling rival offers, according to people familiar with the matter. The banks expected to be able to sell the bonds to hedge funds and other insurance companies that were keen to buy pieces of the portfolio, known as Maiden Lane II.

But hints of problems in the market surfaced that month. The day after AIG's offer, financial markets were jolted by the earthquake and tsunami that struck Japan. MKP Capital Management, a $4.5 billion hedge-fund manager that bought discounted mortgage bonds during the crisis, sold the bulk of its holdings of residential and commercial mortgage debt.

MKP chief executive Patrick McMahon said the fund, after poring over data at its offices in Manhattan and London, sold risky assets in March in light of "deteriorating fundamentals" in the U.S. economy and housing, such as the growing inventory of unsold homes and swelling numbers of borrowers seriously delinquent on their loans.

"When we saw how fragile the market and the economy became after the disaster in Japan, we exited subprime completely," Mr. McMahon said in an interview. He declined to say how much MKP sold.

The ABX, an index that tracks prices of subprime mortgage bonds, weakened in mid-March but largely recovered by the end of the month, according to data from Markit. On March 30, the Fed rejected AIG's bid and, citing improved market conditions, said it would auction off the portfolio piecemeal over time.

The central bank kicked off weekly sales which went well initially, with investment banks and investors buying most of the bonds the Fed offered for sale. In April, the ABX, slipped about 4%, from 58.5 cents on the dollar to 56.4 cents.

By mid May, the Fed's sales were hitting a wall. The market was satiated. The central bank put the sales on hold for a few weeks just as economic warning signals flashed. Home prices fell sharply in the first quarter, sinking to 2002 levels and dashing hopes of a near-term recovery. The U.S. unemployment rate increased amid weak job growth in May, and in Europe, fears increased that Greece wouldn't be able to repay its debt sparked renewed concerns of a sovereign-debt crisis.

Banks and investors that had just bought mortgage bonds from the Fed found themselves sitting on potential losses, forcing them to pivot. They scrambled to protect their holdings by making bearish bets on the ABX, and an index known as the CMBX that tracks commercial mortgage-backed securities, buying credit-default swaps that would pay out if bonds defaulted. The trades accelerated declines in both indexes and pushed down prices of many mortgage securities.

In late May, French-Belgian bank Dexia SA said it would sell off $8.5 billion in U.S. residential mortgage bonds to clean up its books, raising concerns of more supply hitting the market. The Fed held another mortgage bond auction in early June, but sold only half the securities it offered up. By then, the ABX had plunged to 47 cents on the dollar, down 20% from April, and even corporate high-yield "junk" bonds were losing value.

"It definitely felt like contagion," said Sean Dobson, CEO of Amherst Holdings LLC, a broker-dealer that specializes in mortgage debt. Mr. Dobson says many mortgage bonds were "grossly overvalued" earlier in the year and prices are now more reflective of the bonds' actual values given the absence of a housing recovery.

Any quick moves can cause big sales as risky debt securities move in tandem in today's market—a change from how markets reacted before the crisis when risky mortgage securities might not move in lockstep with the stock market, says Sreeniwas Prabhu, managing partner of Atlanta money manager Angel Oak Capital Advisors LLC, which invests in mortgage securities. "It becomes a food fight," Mr. Prabhu said.

In light of the recent turmoil, Dexia intends to wait till market conditions are better before selling its mortgage bonds, according to a person familiar with the matter.

Wall Street traders, meanwhile, are waiting to find out whether the Fed, which has so far sold a third of the Maiden Lane II portfolio, will put its auctions on hold for the rest of the summer. At current prices, the Fed would fetch less than what AIG originally offered for the bonds.

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Global Finance: Massachusetts Joins Forex Fight

By Carrick Mollenkamp
327 words
14 June 2011
The Wall Street Journal
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C3
English

Massachusetts officials joined a growing number of inquiries into how banks process currency trades, harshly criticizing Bank of New York Mellon Corp. for allegedly overcharging the state's pensioners for foreign exchange.

In a report, Massachusetts' treasurer and pension executive director said BNY Mellon overcharged the $50 billion Massachusetts Pension Reserves Investment Management board by more than $20 million for foreign exchange between Jan. 1, 2007 and May 11, 2011.

In a statement, BNY Mellon said it "is confident that it provides clients and their investment managers with competitive and attractive FX pricing. Describing our pricing as 'overcharging' is wrong and ignores the substantial, cost-effective benefits our service provides to our custody clients and their professional investment managers." The bank said it hopes to work with the Massachusetts fund "to address their concerns."

Massachusetts' allegations represent the latest attack on currency-trading practices by BNY Mellon and rival custody bank State Street Corp. by states including California, Virginia and Florida, as well as Los Angeles County. Attorneys general in those states, as well as the pension manager in Los Angeles, allege that custody banks have improperly charged state and local pension funds for currency trades.

Custody banks historically have acted as custodian for investment firms' securities while handling back-office administrative work. The banks also execute currency transactions for institutional investors.

A whistleblower group has sued BNY Mellon and State Street, accusing them of improperly pricing currency trades for state and local pension funds. State attorneys general in Virginia, Florida and California have taken over the whistleblower lawsuits. Federal agencies also are investigating.

BNY Mellon and State Street have denied the allegations.

Massachusetts is weighing its legal options, Massachusetts Treasurer Steven Grossman said on Monday.

Mr. Grossman said his office, the pension board, and the Massachusetts attorney general will explore legal options to recoup the excess foreign-exchange costs.

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THE WALL STREET JOURNAL.

Markets

SEC Deepens Probe of Forex Trading; Regulators Are Examining How State Street and BNY Mellon Characterized Transactions to Clients

By Carrick Mollenkamp And Jean Eaglesham
876 words
24 May 2011
The Wall Street Journal Online
WSJO
English

Federal securities regulators are taking a deeper look at the role of big banks in executing currency trades for clients.

The Securities and Exchange Commission is examining whether two major banks made proper representations to pension-fund clients about how their currency trades would be handled and priced, according to a person familiar with the matter.

At issue is whether "custody" banks—which handle securities and back-office tasks for institutional investors—are overcharging public pension funds for trading in the $4 trillion-a-day foreign-exchange market.

The SEC probe, which is examining the currency-trading activities of Bank of New York Mellon Corp. and State Street Corp., marks a new level of scrutiny by authorities. It comes on the heels of previously publicized probes by the Justice Department and three state attorneys general into whether the banks fairly charged clients for currencies.

It hadn't been previously known that the SEC was examining BNY Mellon's activities. And the nature of the SEC investigation hadn't been made public.

State Street and BNY Mellon say they have done nothing wrong and will defend themselves. State Street said it will "cooperate fully" with the SEC inquiry.

BNY Mellon says it made proper client representations and is cooperating with inquiries by "certain governmental authorities." An SEC spokesman declined to comment.

A whistleblower group led by investor Harry Markopolos has sued BNY Mellon in Virginia and Florida, and rival State Street in California, accusing them of improperly pricing currency trades for state and local pension funds. The banks are fighting the suits.

In a separate development, State Street recently received the names of bank whistleblowers who provided information in the California suit, according to people familiar with the matter.

The SEC typically doesn't have direct jurisdiction over the foreign-exchange market. And the private agreements between custody banks and their clients appear to give banks wide discretion over how they charge funds for currency transactions.

But the SEC can determine whether the banks' transactions with the pension funds breached securities laws. One issue the agency is examining is whether the banks misrepresented how they intended to carry out the foreign-exchange trades, according to the people familiar with the matter.

In previously filed lawsuits, several pension funds alleged the banks falsified foreign-exchange rates for the funds to the benefit of the banks.

In the California suit, the attorney general's office previously has said State Street contractually was obligated to charge the "interbank" rate—the price at which major banks buy and sell foreign currencies—at the time of a trade for California pension funds. Instead, the attorney general alleged State Street consistently charged "at or near the highest rate of the day."

State Street said in a court filing in April that the allegations "are premised upon an incorrect reading of the parties' agreements."

The bank said the foreign-exchange rates it provided California pension funds "complied with the parties' agreements—the agreements required that the rates were 'based on' the interbank rates and they in fact were based on interbank rates."

In a separate dispute, a Los Angeles pension fund has asserted its agreement with BNY Mellon called for the bank to act in its best interests and offer best-possible currency pricing.

BNY Mellon has responded that the Los Angeles fund knew, or should have known, that BNY Mellon doesn't act in the fund's best interests in conducting currency trades.

In correspondence this year with the Los Angeles County Employees Retirement Association, BNY Mellon said it had adhered to all of its agreements and it "has also consistently made clear that it executes all foreign currency transactions as counter-party, and on a principal basis." A principal basis means the bank doesn't act in a client's interests when pricing trades.

A Wall Street Journal analysis of 9,400 trades over a decade showed BNY Mellon priced 58% of currency trades for the Los Angeles fund within the 10% of each day's "interbank" trading range that was least favorable to the fund. A BNY Mellon spokesman confirmed the accuracy of the data but said there was nothing improper about the practice.

The SEC probe is being led from the agency's Boston office.

Mr. Markopolos, of the whistleblower group, is a Boston-area investor who spent years warning the SEC that Bernard Madoff ran a Ponzi scheme. He began looking into the currency markets in 2005, people familiar with the matter say. He subsequently began working with insiders at banks to gather data on the bank's internal practices. Mr. Markopolos declined to comment.

The production of the whistleblower names in the California case means State Street could potentially assess the information bank insiders have provided.

In a court filing in Sacramento, Calif., last month, State Street said it sought information "that relates to—and critically, will identify to State Street for the first time—the 'insiders' of this case who purport to have direct knowledge of [State Street's] alleged misconduct."

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THE WALL STREET JOURNAL.
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SEC Deepens Probe of Forex Trading --- Regulators Are Examining How State Street and BNY Mellon Characterized Transactions to Clients

By Carrick Mollenkamp and Jean Eaglesham
874 words
24 May 2011
The Wall Street Journal
J
C1
English

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State Street and BNY Mellon say they have done nothing wrong and will defend themselves. State Street said it will "cooperate fully" with the SEC inquiry.

BNY Mellon says it made proper client representations and is cooperating with inquiries by "certain governmental authorities." An SEC spokesman declined to comment.

A whistleblower group led by investor Harry Markopolos has sued BNY Mellon in Virginia and Florida, and rival State Street in California, accusing them of improperly pricing currency trades for state and local pension funds. The banks are fighting the suits.

In a separate development, State Street recently received the names of bank whistleblowers who provided information in the California suit, according to people familiar with the matter.

The SEC typically doesn't have direct jurisdiction over the foreign-exchange market. And the private agreements between custody banks and their clients appear to give banks wide discretion over how they charge funds for currency transactions.

But the SEC can determine whether the banks' transactions with the pension funds breached securities laws. One issue the agency is examining is whether the banks misrepresented how they intended to carry out the foreign-exchange trades.

In previously filed lawsuits, several pension funds alleged the banks falsified foreign-exchange rates for the funds to the benefit of the banks.

In California, where a whistleblower and state attorney general have sued State Street, the attorney general's office previously has said State Street contractually was obligated to charge the "interbank" rate -- the price at which major banks buy and sell foreign currencies -- at the time of a trade for California pension funds. Instead, the attorney general alleged State Street consistently charged "at or near the highest rate of the day."

State Street said in a court filing in April that the allegations "are premised upon an incorrect reading of the parties' agreements."

The bank said the foreign-exchange rates it provided California pension funds "complied with the parties' agreements -- the agreements required that the rates were 'based on' the interbank rates and they in fact were based on interbank rates."

In a separate dispute, a Los Angeles pension fund has asserted its agreement with BNY Mellon called for the bank to act in its best interests and offer best-possible currency pricing.

BNY Mellon has responded that the Los Angeles fund knew, or should have known, that BNY Mellon doesn't act in the fund's best interests in conducting currency trades.

In correspondence this year with the Los Angeles County Employees Retirement Association, BNY Mellon said it had adhered to all of its agreements and it "has also consistently made clear that it executes all foreign currency transactions as counter-party, and on a principal basis." A principal basis means the bank doesn't act in a client's interests when pricing trades.

A Wall Street Journal analysis of 9,400 trades over a decade showed BNY Mellon priced 58% of currency trades for the Los Angeles fund within the 10% of each day's "interbank" trading range that was least favorable to the fund. A BNY Mellon spokesman confirmed the accuracy of the data but said there was nothing improper about the practice.

The SEC probe is being led from the agency's Boston office.

Mr. Markopolos, of the whistleblower group, is a Boston-area investor who spent years warning the SEC that Bernard Madoff ran a Ponzi scheme. He began looking into the currency markets in 2005, people familiar with the matter say. He subsequently began working with insiders at banks to gather data on the bank's internal practices. Mr. Markopolos declined to comment.

The production of the whistleblower names in the California case means State Street could potentially assess the information bank insiders have provided.

In a court filing in Sacramento, Calif., last month, State Street said it sought information "that relates to -- and critically, will identify to State Street for the first time -- the 'insiders' of this case who purport to have direct knowledge of [State Street's] alleged misconduct."

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THE WALL STREET JOURNAL.

Markets
SEC Investigating State Street Foreign Exchange

By Carrick Mollenkamp And Gregory Zuckerman
348 words
12 May 2011
The Wall Street Journal Online
WSJO
English

The Securities and Exchange Commission is investigating State Street Corp.'s foreign-exchange trading on behalf of pension funds in a sign that law-enforcement probes into how custody banks process tens of thousands of foreign-exchange trades are widening.

State Street, based in Boston, revealed the SEC inquiry in a quarterly securities filing this week. The SEC's inquiry hadn't been previously disclosed by State Street, one of the world's largest custody banks.

In a statement, State Street said, "As we have disclosed previously, State Street is responding to inquiries from various regulatory bodies regarding its foreign exchange practices. We will cooperate fully with the SEC in its inquiry and we stand behind our business practices and will continue to defend ourselves against any allegations of wrong doing."

An SEC spokeswoman declined comment.

The SEC joins a growing list of law-enforcement agencies now investigating how State Street and New York rival Bank of New York Mellon Corp. process currency transactions for state and local pension funds. The inquiries are examining whether the two banks properly charged state and local pension funds to exchange currency to complete global securities transactions.

The inquiries were sparked by a whistleblower legal group that has sued the banks in California, Virginia and Florida. The legal group sued State Street in California and BNY Mellon in Virginia and Florida.

The banks have denied allegations of improper currency transactions and have said they will defend against them.

State Street previously had disclosed probes by the Justice Department and the California attorney general. BNY Mellon's quarterly filing, also filed this week, didn't disclose an SEC inquiry.

This week's securities filing disclosed previously known inquiries being pursued by Virginia and Florida prosecutors.

A BNY Mellon spokesman declined comment beyond its latest securities filing, which said the New York bank is cooperating with governmental inquiries.

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THE WALL STREET JOURNAL.
U.S. EDITION

State Street Discloses Forex Probe

By Carrick Mollenkamp and Gregory Zuckerman
331 words
12 May 2011
The Wall Street Journal
J
C2
English

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THE WALL STREET JOURNAL.

Business
Mini 'Crashes' Hit Commodity Trade

By Carolyn Cui And Tom Lauricella
946 words
5 May 2011
The Wall Street Journal Online
WSJO
English

A boom in computerized, high-speed trading in commodities and currencies has coincided with a series of "flash crashes" in those markets, even though the stock market hasn't seen a repeat of the harrowing plunge of a year ago.

The U.S. dollar sank 5% against the Japanese yen within minutes on March 16, one of its biggest moves ever. Also that month, cocoa-futures prices dropped 13% in just seconds on the IntercontinentalExchange Inc. before rebounding almost as quickly. In February, the sugar market took a dive of 6% in just one second.

Like the stock market "flash crash," which occurred a year ago on Friday, these big moves are the unintended consequences of an influx of high-frequency and algorithmic traders into markets that aren't equipped to deal with them.

High-frequency and algorithmic traders use computer programs to buy and sell assets, taking advantage of small gaps in prices to generate profits.

In both the commodities and currency markets, the growth of computerized and high-frequency trading has led to the exit of key human market makers, whose jobs are to match buyers and sellers and provide liquidity to the market. Now, as in the stock market, that role is increasingly being played by computer programs. If the traders using those programs pull back from the market, then big "buy" or "sell" orders are effectively placed into a vacuum, leading to sudden, big swings.

"As we saw with the equity markets, it increases the probability of surprise distortions," said Jonathan Lewis, chairman of the investment committee at Samson Capital Advisors. "This is something that investors, policy makers and central banks should all be concerned about."

The stock market's 10-minute, 600-point decline reverberated through the investment world. It took two months for stocks to regain their pre-flash-crash levels, as investors last summer bought on their conviction the Federal Reserve would take action to boost the economy. The more recent flash crashes had smaller impacts but affected companies that need to hedge exposures to commodities and currencies.

High-frequency traders now account for 28% of the total volume in the futures markets, which include currencies and commodities, up from 22% in 2009, according to data from Aite Group, a Boston-based research firm. These traders now account for 53% of stock-market trading volume, down from 61% in 2009, according to data from Tabb Group.

The sudden tumbles have forced commodities-markets operator ICE to implement trading rules to prevent big swings. ICE is also considering expanding the use of "circuit breakers" in markets like cocoa, a spokesman said. A circuit breaker halts trading when a market or asset is sharply up or down.

As was the case in stocks, many in the industry feel high-frequency trading is benefiting both markets, providing another kind of liquidity and a real-time reading of these otherwise opaque markets. "We think high-frequency traders play a necessary and beneficial role by providing liquidity, and that they mitigate volatility" in the markets, a spokesman for ICE said.

Chip Lowry, chief operating officer for State Street Corp.'s electronic trading platform Currenex, says he doesn't think the emergence of computerized and high-speed trading "is an issue."

The timing of some of these mini crashes shows the impact of computerized trading. The dollar tumbled against the yen at 5 p.m. in New York on March 16, right as several major banks had shut down their electronic-trading programs as part of a routine handoff to colleagues in Asia, when a barrage of buy orders for the currency stormed the market. With few traders around, the orders, combined with forced buying linked to options, were set loose into a void.

Cocoa's flash crash came at about 10:30 a.m. New York time on March 1, after orders to sell hundreds of cocoa contracts flooded the market. Too few buy orders were there to soak up the sale. Cocoa plunged $450 in one minute, to a low of $3,217 a metric ton. The sell orders were unusually large for the cocoa futures market, which typically handles about 20,000 contracts a day.

"The electronic platform is too fast; it doesn't slow things down" like humans would, said Nick Gentile, a former cocoa floor trader. "It's very frustrating" to go through these flash crashes, he said.

Cocoa's flash crash had been years in the making, according to Mr. Gentile. The tiny market—it has contracts outstanding of just $6 billion, compared with the $16.6 trillion market capitalization of U.S. stocks—was taken over by ICE and converted to an electronic market in 2007.

Gradually, market makers left the business, leaving fewer people to match orders.

The same is happening in the sugar market, provoking outrage within the industry. In a February letter to ICE, the World Sugar Committee, which represents large sugar users and producers, called algorithmic and high-speed traders "parasitic."

"Their presence only serves to enrich themselves at the expense of the traditional market users," the letter said.

Still, the exchanges are caught in a tough balancing act: attracting new market participants while keeping their core constituents happy—the producers and users of the commodities, which rely on the markets to buy and sell and hedge their risk.

"Unfortunately, we are always going to be at risk of these types of flash crashes," said Paul Zubulake, a senior analyst at Aite Group.

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THE WALL STREET JOURNAL.

Today's Markets
Markets

Blue Chips Bounce Back as J&J Leads Stocks Higher

By Jonathan Cheng
564 words
19 April 2011
07:19 PM
The Wall Street Journal Online
WSJO
English

Stocks clawed back some of Monday's losses, as positive earnings news helped buoy the market.

The Dow Jones Industrial Average rose 65.16 points, or 0.5%, to end Tuesday's session at 12266.75, while the Standard & Poor's 500-stock index added 7.48 points, or 0.6%, to 1312.62, and the Nasdaq Composite edged up 9.59 points, or 0.4%, to 2744.97.

The modest gains came one day after the Dow fell 140 points on credit-ratings firm Standard & Poor's decision to lower its outlook on the U.S. government's triple-A credit rating. Traders and investors said that many of those worries were being shrugged off a day later.

"What strikes me is the absolute skittishness of this market and the speed with which it can change its sentiment," said Max Bublitz, chief markets strategist at SCM Advisors. "To me, the trend is in place, and the rest is just noise."

Johnson & Johnson led the Dow higher, gaining $2.23, or 3.7%, to $62.69, after the blue-chip health-care and consumer-products company beat first-quarter earnings expectations and raised its full-year earnings outlook. The New Brunswick, N.J., conglomerate didn't address negotiations to acquire medical-device maker Synthes.

Energy stocks also were strong, as oil jumped to over $108 a barrel. Exxon Mobil gained 70 cents, or 0.8%, to 83.80, while Chevron added 90 cents, or 0.9%, to 105.40.

Financial stocks were mixed as a number of big banks reported earnings. Goldman Sachs Group's first-quarter earnings and revenue easily topped forecasts, but concerns arose about the sustainability of its gains. Goldman fell 1.92, or 1.3%, to 151.86.

"Goldman is talking about regulatory uncertainty, citing the economy, lower client activity. For a trading firm and investment bank, that's a code word for 'less going on,' less opportunities to be making money on a transactional basis," said Michael Shea, managing partner at Direct Access Partners, an institutional brokerage.

Northern Trust tumbled 2.73, or 5.3%, to 48.67, after first-quarter profit fell on persistently low interest rates, missing Wall Street expectations. Bank of New York Mellon dropped 85 cents, or 2.9%, to 28.35, after earnings from continuing operations at the custodial bank missed consensus estimates, while State Street gained 1.02, or 2.3%, to 45.69, after revenue and operating earnings beat expectations.

U.S. Bancorp fell 31 cents, or 1.2%, to 25.25, and Comerica dropped 82 cents, or 2.2%, to 36.64, as the lenders saw their earnings soar, though in both cases the gains came largely from drops in loan-loss provisions. Citigroup climbed 11 cents, or 2.5%, to 4.53, while J.P. Morgan Chase gained 69 cents, or 1.6%, to 44.65.

Texas Instruments slipped 25 cents, or 0.7%, to 34.54, after reporting late Monday that first-quarter earnings and its second-quarter outlook were below estimates.

In economic news, U.S. home construction in March bounced back from the previous month's low levels, though overall numbers for the sector remained weak.

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THE WALL STREET JOURNAL.

Business
Low Rates Pressure Trust Banks

By David Benoit
765 words
20 April 2011
The Wall Street Journal Online
WSJO
English

NEW YORK—The U.S. trust-bank triumvirate reported some improving revenue in the first quarter, but low interest rates continued to keep the three from turning top-line growth into similar bottom-line expansion.

On the foreign-exchange front, the three biggest standalone trust banks all said volumes were higher as clients look for more currency-trading services. But volatility in currencies was lower, meaning the ability to make profits from large swings in currencies was gone, and reducing the profitability of each trade. The banks said recent negative attention about pricing on foreign-exchange trades hasn't hurt client demand.

Of the group, only State Street Corp. managed to top analysts' expectations for profit, while both Bank of New York Mellon Corp. and Northern Trust Corp. missed forecasts.

State Street shares rose 1.9% to $45.53 in recent trading, while BNY Mellon fell 2.8% to $28.40 and Northern Trust slipped 1.6% to $50.57.

Trust banks act as custodians and servicers for corporations and Wall Street, and their results are heavily tied to market actions.

At Boston's State Street, assets under management rose sharply and revenue climbed 10% to $2.33 billion on an operating basis, topping the $2.29 billion analysts expected, according to Thomson Reuters.

But profit fell 5.3% to $466 million, or 93 cents a share, largely because of one-time gains in the prior year. Excluding one-time charges, earnings would have risen to 88 cents from 75 cents and beaten the 86 cents analysts expected.

Highlighting the trust banks' troubles with low interest rates, State Street's net interest revenue—a measure of how much revenue is generated on interest-bearing assets—dropped by 13%. The net interest margin, which measures interest gains as a ratio to expenses on those assets, fell to 1.85% from 2.34%.

State Street brought in more fees for servicing and trading than the prior year. In foreign exchange, which the bank includes in trading, revenue was up 19% on higher volumes, but offset by lower volatility.

At BNY Mellon, core earnings missed expectations despite growing assets under management and double-digit percentage fee growth.

Profit rose 12% to $625 million, or 50 cents a share; excluding one-time charges, it would have hit 55 cents a share. Analysts predicted a profit of 57 cents.

Fee revenue rose 12% to $2.83 billion but net interest income slid 8.8% and the net interest margin fell to 1.49% from 1.89%

In foreign exchange, BNY Mellon reported a 1% drop in revenue, and a 16% drop from the fourth quarter. Chief Executive Bob Kelly said foreign-exchange volumes were up 25% but the lack of volatility wiped out the growth.

Mr. Kelly said that the rise in fees has been his number-one priority and there "is no question we are adding business." But he isn't expecting interest rates will rise and the bank is positioning itself to increase its exposure to fees rather than interest rates.

Still, if there were higher interest rates or increased volatility, Kelly said he would view it as "the icing on the cake."

State Street and BNY Mellon are both facing lawsuits alleging the banks unfairly charged pension funds in foreign exchange. State Street said the product named in the suits made up only 2.7% of its foreign-exchange revenue last year. BNY Mellon said it represented only a part of its foreign-exchange revenue.

Mr. Kelly added that clients say the service is attractive and, even with the bad publicity, the bank expects to capture more market share as it now does only about a quarter of its clients' total foreign-exchange trading.

For Northern Trust, profit fell 3.9% to $151 million, or 61 cents a share, missing the 65 cents a share Wall Street predicted. Revenue was flat at $879.9 million, well short of the $928 million analysts expected. Fees from trust, investment and other services were essentially flat with the prior year, and up 2% from the prior quarter.

Northern Trust managed to buck the trend by actually boosting its net interest income by 2% from the prior year, despite lamenting low interest rates. But the bank's net interest margin fell to 1.32% from 1.44%.

In foreign exchange, the Chicago bank said trading income was up 6%, which it attributed to higher volume and some volatility compared to last year.

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THE WALL STREET JOURNAL.
U.S. EDITION

Global Finance: Low Rates Pinch Trust Banks --- Lenders Say Suits Over Foreign-Exchange Fees Haven't Hurt Trading Demand

By David Benoit
731 words
20 April 2011
The Wall Street Journal
J
C3
English

NEW YORK -- The U.S. trust-bank triumvirate reported improving revenue in the first quarter, but low interest rates continued to keep the three from turning top-line growth into similar bottom-line expansion.

State Street Corp. topped analysts' expectations for profit, but both Bank of New York Mellon Corp. and Northern Trust Corp. missed forecasts.

The three biggest stand-alone trust banks said foreign-exchange volumes were higher as clients looked for more trading services. But volatility was lower, meaning the ability to make profits from large swings in currencies was gone, reducing the profitability of each trade. The banks said recent negative attention about pricing on foreign-exchange trades hasn't hurt client demand.

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But profit fell 5.3% to $466 million, or 93 cents a share, largely because of one-time gains in the prior year. Excluding one-time charges, earnings would have risen to 88 cents from 75 cents and beaten the 86 cents analysts expected.

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Exchange-Traded Funds (A Special Report) --- Information, Please: Research firms battle to be the place to go for investors looking to learn more about ETFs

By Ian Salisbury
1,087 words
18 April 2011
The Wall Street Journal
J
R4
English

The race is on to become the Morningstar of ETFs.

Exchange-traded funds have been one of the fastest-growing corners of the fund business, grabbing roughly $1 for every $2 that flowed into conventional long-term mutual funds in 2010. But it's not just fund companies that are sniffing opportunity.

Media and research firms from Standard & Poor's to IndexUniverse are competing to be the chief supplier of information to ETF investors, much the way Chicago-based Morningstar Inc. won over mutual-fund investors a generation ago. Amid the scramble, competitors including Morningstar itself have launched a slew of online tools, many of them free, such as rankings and search engines that help compare the hundreds of ETFs available.

The rivals have their work cut out for them. ETFs' complex mechanics -- the funds typically resemble index mutual funds, yet trade throughout the day like stocks -- make analyzing and ranking the investments tricky. Some aspects of ETFs' performance are unique, like how consistently their trading prices match the prices of their underlying holdings throughout the day.

ETF providers including BlackRock Inc., State Street Corp. and Vanguard Group have joined the fray, loading their websites with far more sophisticated analysis and tools than most conventional fund companies offer. Brokerage firms want to be seen and heard, too. Analysts at Morgan Stanley Smith Barney and Wells Fargo Advisors, for example, issue regular ETF market reports.

Morningstar, meanwhile, isn't resting on its laurels. It has made a number of improvements in the way it covers ETFs in recent years. The company now has 16 analysts who research ETFs, up from two just four years ago. It also has upgraded its website, adding up-to-the-minute price quotes and detailed information about bid-asked spreads.

In February, the company began calculating what it calls "total cost analysis." It starts with fund expenses, but also looks at whether a fund makes money by lending its underlying shares to short sellers -- a frequent ETF practice -- and what the fund does with that money. Another focus is liquidity: to what degree the share price will suffer when large blocks are sold.

While the new Morningstar tools are geared toward institutional traders and aren't available on the company's free website, morningstar.com, the company expects to incorporate findings from using those tools into its retail research.

Scott Burns, the head of Morningstar's ETF research team, says the company isn't done, either. The next step is to integrate the research of Morningstar's stock analysts. The aim, says Mr. Burns, is not just to gauge which technology- or growth-focused ETF is best, for example, but also on whether a focus on technology or growth stocks is a good strategy in the first place.

"You have to be able to answer both types of questions," he says.

The most recent challenger to Morningstar is in many ways an unlikely one. Until ETFs hit the mainstream, Index Publications LLC was a tiny trade publisher. Its flagship title, the Journal of Indexes (which it purchased in 1999 from Dow Jones & Co., publisher of The Wall Street Journal), runs wonky articles on topics like how to define "midcap" stocks.

With ETFs putting a brighter spotlight on index investing, the company -- often known by its Web moniker, IndexUniverse -- has worked hard to win a larger audience. It has hired additional reporters and started a blog that focuses on more mainstream investing issues.

One of IndexUniverse's biggest efforts is a free website feature, introduced in March, that helps investors search for ETFs and related exchange-traded notes, or ETNs, in ways that aren't always possible on Morningstar's basic site.

One example: The tool allows investors to directly compare 11 products that target India, such as the Market Vectors Indian Rupee/USD ETN and the WisdomTree India Earnings ETF. Morningstar classifies the rupee fund in a currency category and the WisdomTree ETF in an Asia/Pacific stock category that also includes funds focused on Australia and South Korea.

"It's a different perspective," says Matt Hougan, president of ETF analytics for IndexUniverse.com.

Name recognition generally isn't a problem for Standard & Poor's, the McGraw-Hill Cos. brand famous for publishing the S&P 500 stock index and rating thousands of bonds. But the company, which started marketing its ETF research in 2009, wasn't necessarily known for fund research.

The result: a focus on ETFs' underlying stocks, rather than the funds themselves. S&P grades ETFs based on a blend of 10 criteria, including a tally of its equity analysts' opinions about each of an ETF's stock holdings; a separate tally of its credit analysts' opinions about those companies' financial health; and computer-driven measures such as scores tied to earnings and dividend growth. S&P accounts for some fund-oriented factors such as investment fees and trading costs as well. But it largely ignores three-, five- and 10-year returns.

A few caveats to keep in mind: S&P doesn't rank bond ETFs, because its methodology is so closely tied to its stock research. The company also makes comparatively little information available to small investors free of charge. The research is largely geared toward financial advisers, but some individual investors may have access to it through discount-brokerage accounts, an S&P spokesman says.

Winning a big following among investors for ETF research can be tough. New York-based Marco Polo XTF Inc. launched its own ETF research website, xtf.com, in 2007. Among the site's innovations was one of the first attempts to help investors quantify the trading costs known as bid-asked spreads. Since then, XTF has hit some bumps, shutting down other business projects and changing ownership.

Chief Executive Mel Herman declines to specify how many subscribers pay for the company's "premium membership" but highlights successes such as a deal to make some of the company's research available through Fidelity Investments' retail brokerage.

"We're out there," he says. "We have a small marketing budget. We're not a household name, but we will be."

Mr. Salisbury is a reporter for Dow Jones Newswires in New York. He can be reached at ian.salisbury@dowjones.com.

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Search Summary

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