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Barclays Sues over Sub-prime Losses

***Wall Street Firm Is Accused of Fraud and Deception;
British Bank Says Hedge Fund Losses Were Hidden***

By Andrew Clark

Barclays' exposure to America's sub-prime mortgage fiasco took a dramatic turn last night as the bank sued the Wall Street firm Bear Stearns for fraud and deception over the loss of hundreds of millions of dollars in an ill-fated hedge fund.

In a lawsuit filed in New York, Barclays accused Bear Stearns of systematically hiding losses in a fund which swallowed \$400m (£200m) of the British bank's money. The fund had to be bailed out in June after reaching the brink of collapse following a disastrous series of investments in mortgage-backed securities.

Barclays described the fund's demise as "one of the most high profile and shocking hedge fund failures in the last decade". The suit alleges that up to the last days before the bail-out, Bear Stearns executives engaged in a cover-up to hide the slump in its value.

In addition to Bear Stearns, the suit targets the Wall Street firm's senior managing director for asset management, Matthew Tannin. A third defendant, fund manager, Ralph Cioffi, is already under investigation by US federal prosecutors for withdrawing his own money from the hedge fund while assuring investors not to worry.

"The defendants entered intentionally into a relationship in which Barclays placed trust and confidence in them," the suit says. It describes Bear Stearns' conduct as "wilful, malicious, reckless and without regard to Barclays' rights and interests".

Barclays has been under pressure over its exposure to the credit crunch, which has frequently depressed its shares. The bank announced last month that it had written off \$1.7bn in loans and mortgages.

Its involvement in Bear Stearns' hedge fund first became public over the summer. The British bank is understood to have lent \$400m to a complex vehicle linked to the fund which was used by Bear Stearns to leverage returns for its clients. Little of the money has been recovered.

According to Barclays, Bear Stearns frequently diverged from agreed guidelines on the type of investments to be made by the fund. Between 75% and 100% of the fund's portfolio was supposed to go into assets with top-notch credit ratings of between AAA and AA minus.

The suit says Bear Stearns and Cioffi "hatched a plan to make more money for themselves" by creating an unauthorised new investment vehicle which they planned to float.

Barclays details a series of lunch meetings in New York at which its staff were assured that the fund was going well. But it says detailed updates of performance tended to be provided late and incomplete. Throughout the spring of 2007, it says, Tannin repeatedly used the word "great" to describe progress.

Barclays is not alone in suing Bear Stearns over the debacle. A New York securities lawyer, Jake Zamansky, has mounted a lawsuit on behalf of clients who lost money in the fund, brought under the name of a 73-year-old American investor who lost his retirement savings of \$500,000.

Criminal prosecutors are examining whether Cioffi, who managed the fund, improperly withdrew \$2m of his own money while providing bullish updates to clients about the fund's performance - a move characterised as a hedge fund manager "hedging himself". Cioffi recently left the firm, although Bear Stearns has not disclosed the circumstances of his departure.

A Bear Stearns spokeswoman said the firm denied any wrongdoing and said Barclays was a "highly sophisticated financial institution" which ought to be able to calculate investment risk.

"While we do not like to see investors or counterparties lose money, we believe this lawsuit is an attempt by Barclays to avoid taking responsibility for its own actions," the spokeswoman said. "We are not responsible for Barclays' losses and intend to defend vigorously against Barclays' claims."

Bear Stearns has faced intense heat of its own over the funds' failure which led to the departure of its chief operating officer, Warren Spector.

In financial results due today, Bear Stearns will reveal the extent of the damage to its balance sheet arising from the credit crunch. Its chairman, Jimmy Cayne, and fellow executives are likely to forgo their annual bonuses as a result of the havoc.