

[Home](#) | [Previous Page](#)

## U.S. Securities and Exchange Commission

### SECURITIES AND EXCHANGE COMMISSION

Litigation Release No. 22008 / June 21, 2011

***Securities and Exchange Commission v. J.P.Morgan Securities LLC (f/k/a J.P. Morgan Securities Inc.), 11-Civ.-4206 (Berman, J.) (S.D.N.Y. filed June 21, 2011)***

***Securities and Exchange Commission v. Edward S. Steffelin, 11-Civ.-4204 (Cedarbaum, J.) (S.D.N.Y. filed June 21, 2011)***

**J.P. Morgan Securities to Pay \$153.6 Million to Settle SEC Charges of Misleading Investors in CDO Tied to U.S. Housing Market**

**Harmed Investors Getting their Money Back, Firm to Pay Penalty and Change Practices**

The Securities and Exchange Commission (SEC) today charged J.P. Morgan Securities LLC (f/k/a J.P. Morgan Securities Inc.) (J.P. Morgan Securities) for misleading investors in connection with a synthetic collateralized debt obligation (CDO) J.P. Morgan Securities structured and marketed. This synthetic CDO, Squared CDO 2007-1 (Squared), was tied to the performance of residential mortgages and was structured and marketed in early 2007 when the United States housing market was beginning to show signs of distress. The SEC also brought charges against an investment advisory firm who participated in the transaction.

#### **J.P. Morgan Securities**

According to the SEC's complaint against J.P. Morgan Securities, filed in the U.S. District Court for the Southern District of New York, the investment portfolio for Squared consisted primarily of credit default swaps (CDS) referencing other CDO securities whose value was tied to the U.S. residential housing market. The SEC alleges that the marketing materials for Squared all represented that its investment portfolio was selected by GSCP (NJ) L.P. (GSC), a registered investment adviser with experience analyzing credit risk in CDOs. Undisclosed in the marketing materials and unknown to investors, the Magnetar Capital LLC hedge fund, which was poised to benefit if the CDOs defaulted, played a significant role in selecting which CDOs should make up the portfolio. While participating in the selection of the investment portfolio, Magnetar shorted a substantial portion of the assets it helped to select by entering into CDS to buy protection on them. The CDO securities Magnetar shorted had a notional value of approximately \$600 million, representing over half of Squared's investment portfolio.

J.P. Morgan Securities sold approximately \$150 million of the so-called "mezzanine" tranches of Squared's liabilities -- representing the riskiest

notes of the deal after the equity -- to a group of approximately 15 institutional investors (Mezzanine Investors). The Mezzanine Investors included a faith-based not-for-profit membership organization headquartered in Minneapolis, Minnesota (Thrivent Financial for Lutherans), a company that provides insurance and retirement products based in Topeka, Kansas (Security Benefit Corporation) and financial institutions located in East Asia (Tokyo Star Bank, Far Glory Life Insurance Company Ltd., Taiwan Life Insurance Company Ltd., and East Asia Asset Management Ltd.). The Mezzanine Investors lost virtually all of their principal.

Without admitting or denying the allegations of the SEC's complaint, J.P. Morgan Securities agreed to settle by consenting to the entry of a final judgment that provides for a permanent injunction from Sections 17(a)(2) and (3) of the Securities Act of 1933, and payment of \$18.6 million in disgorgement, \$2 million in prejudgment interest and a \$133 million penalty, for a total of \$153.6 million. Of that amount, \$125,869,721 will be returned to the mezzanine investors through a Fair Fund distribution and \$27,730,279 will be paid to the U.S. Treasury. The settlement also requires remedial action by J.P. Morgan in its review and approval of offerings of certain mortgage securities. J.P. Morgan's consent notes that it voluntarily made payments totaling \$56,761,214 to certain investors in a transaction known as Tahoma CDO I. The settlement is subject to Court approval.

### **Investment Advisory Firm**

In a separate complaint also filed in the U.S. District Court for the Southern District of New York, the SEC brought charges against Edward S. Steffelin, the GSC employee who was in charge of the team responsible for selecting the portfolio for Squared. Steffelin, among other things, permitted Magnetar to select and short collateral and reviewed and edited the term sheet and pitch book before those materials were provided to investors. Also undisclosed in the marketing materials and unbeknownst to investors, Steffelin was seeking employment with Magnetar during the relevant period.

The SEC's complaint charges Steffelin with violations of Sections 17(a)(2) and (3) of the Securities Act and Section 206(2) of the Investment Advisers Act of 1940. The Commission seeks injunctive relief, disgorgement of profits, prejudgment interest, and civil penalties against Steffelin. Separately, the SEC authorized the institution of administrative proceedings against GSC pursuant to which it consented to the entry of an order requiring GSC to cease and desist from committing or causing violations or future violations of Sections 17(a)(2) and (3) of the Securities Act and Sections 204 and 206(2) of the Advisers Act and Rule 204-2 thereunder. GSC is in bankruptcy, and its settlement is subject to approval by the bankruptcy court.

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The SEC investigation that led to these enforcement actions was conducted by the Enforcement Division's Structured and New Products Unit, led by Kenneth Lench and Reid Muoio. The SEC investigative attorneys were Carolyn Kurr, Jason Anthony, Jeffrey Leasure and Brent Mitchell. The SEC trial attorneys that will handle the litigation against Steffelin are Matt Martens, Jan Folena, and Robert Dodge.

<http://www.sec.gov/litigation/litreleases/2011/lr22008.htm>

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[Home](#) | [Previous Page](#)

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