State Street to Pay $35 Million to Settle SEC Probe

Investigations targeted ‘secret markups’ on trades and operations of a Treasury trading venue

The State Street headquarters building in Boston. Photo: Boston Globe/Getty Images

By
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WASHINGTON— State Street Corp. STT -0.72% will pay $35 million to settle U.S. claims that it overcharged customers using secret markups and failed to fully inform other clients about how its platform for trading Treasury securities worked.

The Boston-based bank agreed to the settlement in an order announced Thursday by the Securities and Exchange Commission. State Street disclosed earlier this year how much it would likely pay to resolve the probe over the markups, which the SEC said generated $20 million in improper revenue for the bank from 2010 to 2011.

Two former State Street executives were indicted last year on related criminal charges that they secretly overcharged six clients for services that involved restructuring investment portfolios or changing asset managers.

The bulk of the settlement, $32.3 million, is related to the transaction markups. The SEC said State Street used false trading statements and other documents to conceal how much it was paid to execute equity and fixed-income trades.

A State Street spokeswoman said the bank deeply regrets "that our clients were impacted and that a small number of our employees failed to meet our expectations." The bank has reimbursed clients and taken steps to strengthen compliance within the unit that was faulted for the misconduct, the spokeswoman said.

In one case involving a Middle East sovereign-wealth fund, the bank's European unit said it wouldn't take any commission on the trades it executed for the fund. But at the direction of Ross McLellan, who was president of a State Street U.S. broker-dealer unit, the bank wound up charging $2.7 million for trades handled in the U.S., according to the SEC's order.

"Agreeing to a fee arrangement and then secretly tucking in hidden, unauthorized markups is fraudulent mistreatment of customers,'' said Paul G. Levenson, director of the SEC's Boston office.

The SEC separately sued Mr. McLellan in May 2016 in federal court in Massachusetts over his part in the alleged scheme. Martin Weinberg, an attorney for Mr. McLellan, said the former banker "has repeatedly and vigorously denied in both the SEC and Department of Justice proceedings that he is culpable and acted in any other than a transparent and appropriate way." Mr. McLellan's criminal trial is scheduled for June 2018, Mr. Weinberg said. The SEC's civil lawsuit against him has been put on hold pending the outcome of the criminal case.

Separately, State Street agreed to pay a $3 million penalty to resolve a probe of its venue for trading Treasury bonds, known as GovEx. In an attempt to attract traders to the platform, which it launched in 2009, the bank gave one firm a special functionality known as "last look." That allowed the firm, which acted like a market maker on GovEx, to reject some trades, the SEC said. Market makers ease trading in securities by offering standing bids to buy and sell stocks, bonds, and other financial assets. The function wasn't disclosed to other firms that used GovEx, the SEC said.

"Last look" was also a controversial practice in currency markets, where trading platforms allowed banks to pull out of trades at the last moment if the market moved against them. In 2015, Barclays PLC paid $150 million to resolve an investigation by New York's banking regulator that it exploited "last look" in a way that sometimes hurt its foreign-exchange clients.

On State Street's platform for trading Treasury securities, "last look" allowed the one participant to reject 57 trades that each had a $1 million face value, the SEC said.

State Street, which marketed GovEx as a "fair and transparent" venue, didn't tell other GovEx participants that their offers to trade had been rejected by a participant who could use "last look" to avoid trading, the SEC said. State Street told one subscriber to GovEx that the special feature didn't exist, the SEC said.

The bank discontinued GovEx in 2015, the SEC said.

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