

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT COMPANY ACT OF 1940
Release No. 33534 / June 27, 2019

ADMINISTRATIVE PROCEEDING
File No. 3-19221

In the Matter of

**State Street Bank and Trust
Company,**

Respondent.

**ORDER INSTITUTING CEASE-AND-DESIST
PROCEEDINGS PURSUANT TO SECTION
9(f) OF THE INVESTMENT COMPANY ACT
OF 1940, MAKING FINDINGS, AND
IMPOSING A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission (“Commission”) deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 9(f) of the Investment Company Act of 1940 (“Investment Company Act”) against State Street Bank and Trust Company (“Respondent” or “State Street”).

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the “Offer”) which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission’s jurisdiction over Respondent and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Cease-and-Desist Proceedings Pursuant to Section 9(f) of the Investment Company Act of 1940, Making Findings, and Imposing a Cease-and-Desist Order (“Order”), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds¹ that:

Summary

From 1998, and lasting into 2015, State Street overcharged its mutual fund clients and other registered investment companies (together, "RICs") for certain reimbursable expenses, and reflected those overcharges in records of RIC clients. State Street acted as a custody bank for RICs. State Street entered into contracts with its RIC clients providing that State Street would bill them for out-of-pocket expenses that State Street incurred in providing services to the RICs. Instead, State Street charged the RICs a total of over \$170 million more than State Street's costs.

The overcharges included expenses related to Society of Worldwide Interbank Financial Telecommunication (or "SWIFT") messages, a secured messaging network used by banks and other financial institutions. State Street misled RICs by identifying SWIFT messages as an out-of-pocket expense in client fee schedules and invoices while in reality State Street applied a large undisclosed markup to SWIFT billings. State Street overcharged approximately 5,000 RICs for SWIFT messages by a total of over \$110 million from 1998 to 2015.

Respondent

State Street is a Massachusetts trust company and a bank that is a member of the Federal Reserve System. It is headquartered in Boston, Massachusetts. State Street is the primary operating subsidiary of State Street Corporation, which is a financial holding company with securities registered with the Commission pursuant to Section 12(b) of the Securities Exchange Act of 1934 and traded on the New York Stock Exchange. State Street acts as custody bank for a wide range of clients, including RICs. With over \$30 trillion of assets under custody and administration, State Street is one of the largest custody banks in the world.

Among other lines of business, State Street acts as a custody bank for RICs, corporate and public retirement plans, insurance companies, foundations, endowments and other investment pools. U.S. Investor Services ("USIS") was the State Street business unit that primarily serviced RIC clients.

As a custody bank, State Street undertakes to hold and safeguard its custody clients' financial assets, including stocks, bonds, and currencies. State Street offers a variety of services to its custody clients, including custody, clearing, payment, and settlement functions, as well as record-keeping functions that include providing clients detailed and itemized records of receipts

¹ The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

and disbursements of cash and other debits and credits. For RIC clients, State Street generally agreed to prepare and maintain certain records, which were the property of the RICs, as required by the Investment Company Act and rules thereunder.

Facts

State Street Overcharged Registered Investment Companies for Out-of-Pocket Expenses, Including by Charging an Undisclosed Markup on SWIFT Messages

1. During the relevant period, State Street entered into fee agreements with its custody clients, which typically provided for compensation to State Street in the form of a fee based on a percentage of the client's assets (also known as an asset-based fee), transaction charges at specified dollar amounts (such as a specified charge to transfer money by wire), and "out-of-pocket" (or "OOP") expenses. State Street's Investment Manager Guide (provided to many investment managers for custody clients) described out-of-pocket expenses as "generally understood in the securities industry to mean costs for items paid by the custodian on behalf of the investor," which are "reimbursable to the custodian."

2. Instead of billing clients in amounts necessary to reimburse State Street for its out-of-pocket costs, State Street charged RICs during the period 1998 to 2015 approximately \$170 million more than its costs for thirteen categories of expenses. Most of these amounts were for charges for outbound SWIFT messages. From 1998 to 2015, State Street charged approximately 5,000 RICs a total of approximately \$110 million more than its costs for SWIFT messages. State Street also charged RICs more than its costs for a variety of other expenses that many State Street fee schedules identified as "out of pocket expenses," including: (i) asset pricing and valuation services from third-party vendors; (ii) Statement on Auditing Standards ("SAS") 99 data feeds, a service whereby State Street provided fund transaction and balance information to funds' audit firms for purposes of required auditing assessments; (iii) Service and Organization Controls ("SOC") 1 reports, which are reports provided by auditors engaged by State Street to review its internal controls relating to processing of client transactions, preparation of client financial statements, and other services; and (iv) preparing SEC Rule 17f-5 reports, which are reports for mutual fund clients to address compliance with requirements when a foreign subcustodian custodies foreign assets. Other categories of expenses for which State Street charged more than its costs included expenses for archiving client records, issuing checks, delivery and courier services, printing and copying, forms and supplies, computer equipment, telephone services, and wire transfers. For many of these categories of expenses, State Street had established a rate to charge clients at some point in the past and failed to update that rate over time. As volumes increased or costs decreased, the gap between the amount that State Street charged and its cost per unit grew. State Street's internal controls did not include procedures to periodically reassess these unit costs.

3. There were two components to the amount that State Street charged to RIC custody clients for SWIFT messages. The first component, a "unit cost," was determined with reference to amounts that the SWIFT organization charged to State Street. The unit cost varied over time and by message type, but was typically between \$0.02 and \$0.15 per message unit (a single SWIFT message might contain multiple message units). The second component was State

Street's \$5.00 per message fee that for many years far exceeded State Street's actual overhead costs to send SWIFT messages. State Street's invoices to clients included a total owed for SWIFT, but did not break out or specify the amounts of the unit cost or message fee charges.

4. Despite SWIFT being presented to clients as an out-of-pocket expense, State Street profited from SWIFT charges because the amounts charged far exceeded its costs. As early as 2002, senior USIS personnel received a report indicating that there was a "mark-up" of the actual SWIFT expense that "varie[d] widely." In 2005, a vice president with financial responsibilities in USIS wrote that although "Swift resides in the OOP language of most client fee schedules" there "has always been a gross up over the costs" and "[t]he issue is we make money on this product, not charged at the true costs." In 2009, an assistant vice president responsible for estimating client profitability in USIS wrote that SWIFT was not a true "pass through OOP" because "we tack on a margin."

5. In April 2009, some USIS client relationship management personnel questioned the \$5.00 charge and whether that amount was necessary to cover State Street's SWIFT-related overhead. Those personnel were informed by a USIS finance assistant vice president that he estimated that State Street's SWIFT overhead worked out to about \$0.25 per message. Later in 2009, employees in State Street's business finance group implemented a rate reduction from \$5.00 to \$0.25, but decided to charge that reduced, more accurate rate only to new clients or clients that State Street had not previously charged for SWIFT. State Street did not move all clients to the new \$0.25 rate in 2009. Absent client-specific exemptions, existing clients continued to pay \$5.00 per message.

6. Personnel within State Street understood that clients would understand SWIFT to be an expense reimbursable in the amount paid by State Street. For example, in April 2009, a senior vice president in client relationship management reported that clients were looking closely at expenses, and that the SWIFT markup was inconsistent with clients viewing out-of-pocket expenses as a pass-through expense. In 2010, USIS initiated a project to develop a standard fee schedule template to be used for contracts with custody clients. A group of employees, including finance, billing, and client relationship personnel, was tasked with developing a fee schedule template. As part of that initiative, the group considered the manner in which State Street described out-of-pocket expenses in fee schedules and how clients would understand the term out-of-pocket expenses, and recognized the large disparity between State Street's SWIFT costs and the amount billed to clients, with "[l]egacy clients being charged a large markup carried over from many years ago (approx. \$5)." Again, rather than correcting the issue for all clients, State Street continued to revisit the SWIFT rate in response to specific clients' requests or during contract renegotiations. In at least one instance thereafter, in late 2015, State Street secured a contract renewal with an existing client by offering to reduce the client's SWIFT costs going forward, without disclosing to the client that State Street had overcharged the client for SWIFT for years.

Custodial Expense Overcharges Were Included in Registered Investment Company Books and Records

7. RICs, including mutual funds, deduct operating expenses from fund assets, meaning that those expenses are borne by fund shareholders. RICs that offer shares to the public are required to provide investors with registration statements and periodic reports with financial statements that specify the RICs' custodial expenses.

8. Investors use expense information to understand the impact of expenses on their investment in a fund, and to compare the costs of investing in one fund or another. RICs also may be subject to limits on the percentage of fund assets that they can spend on expenses. A fund's investment adviser may agree to absorb fund expenses above a specified cap, rather than charge the fund. For these reasons, the accuracy of expenses borne by mutual funds and other RICs is important to investors and investment advisers.

9. In custodial agreements, including agreements signed by advisers to overcharged RICs, State Street agreed to create and maintain records relating to funds' activities and obligations under the custodial agreement in a manner to meet the funds' obligations under the Investment Company Act, including Section 31 and Rules 31a-1 and 31a-2 thereunder. Consistent with Rule 31a-3, State Street and the RICs agreed that such records were property of the fund. From at least 1998 into 2015, State Street maintained records for RICs showing inflated rates for certain out-of-pocket expenses.

10. The overcharged RICs included RICs that also contracted with State Street for fund accounting services. For such RICs, State Street maintained journals that included fund expenses, calculated fixed and variable expenses, and calculated expense caps and expense reimbursement.

Violations

11. As a result of the conduct described above, State Street violated Section 34(b) of the Investment Company Act, which prohibits any person from making any untrue statement of material fact in any registration statement, application, report, account, record, or other document filed or transmitted pursuant to the Investment Company Act or the keeping of which is required pursuant to Section 31(a) of the Investment Company Act and provides that it shall be unlawful for any person so filing, transmitting, or keeping any such document to omit to state therein any fact necessary in order to make the statements therein, in light of the circumstances under which they were made, from being materially misleading.

12. As a result of the conduct described above, State Street caused violations of Section 31(a) of the Investment Company Act and Rule 31a-1(a) thereunder, which require RICs to maintain and keep current the accounts, books, and other documents relating to its business which constitute the record forming the basis for its required financial statements.

13. As a result of the conduct described above, State Street caused violations of Section 31(a) of the Investment Company Act and Rule 31a-1(b) thereunder, which require RICs to maintain records of all receipts and disbursements of cash and all other debits and credits.

Self-Reporting and Remedial Measures

14. In determining to accept State Street's offer, the Commission considered that State Street self-reported its conduct to the Commission and its substantial cooperation given to the Commission staff.

15. In addition, the Commission has taken into account that State Street promptly announced that it would reimburse its custodial clients for the amounts that it determined were in excess of its costs, with interest. State Street also engaged a consulting firm with financial and forensic accounting experience to assess State Street's processes to identify the categories of expenses that were overbilled, to identify the clients that were affected, and to assess State Street's method of calculating the amount of client reimbursements.

16. In imposing the sanctions outlined below, the Commission has also considered State Street's representations to the staff that State Street has taken the following remedial steps:

- a. An initiative to centralize invoicing with a goal of reducing the risk of systematic invoicing errors.
- b. Technological enhancements to reduce invoicing risk through process and controls automation and reductions in manual processing.
- c. Enhanced governance and oversight related to accuracy in customer invoicing, including new controls to monitor and test quarterly costs and usage for SWIFT messaging and other expense categories.
- d. Development of new standard fee schedule templates designed to reduce ambiguity and potential for misunderstanding as to State Street's invoicing methodologies and implementation of a fee schedule exception approval process.
- e. New ethical training, testing, and conduct programs to continue to improve compliance culture.
- f. Additional enhancements to compliance programs and controls systems.

State Street's Undertakings

17. State Street has been carrying out a process to reimburse RICs for the overcharges described above, including reasonable interest thereon. State Street's reimbursement to RICs for overcharges invoiced to RICs in or after October 2011 (the "affected RICs") will satisfy the disgorgement and prejudgment interest ordered below in Section IV.B of the Order. State Street has provided a written description of its reimbursement methodology to the affected RICs and the Commission staff.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondent's Offer.

Accordingly, it is hereby ORDERED that:

A. Pursuant to Section 9(f) of the Investment Company Act, Respondent State Street cease and desist from committing or causing any violations and any future violations of Sections 31(a) and 34(b) of the Investment Company Act and Rules 31a-1(a) and (b) thereunder.

B. Respondent shall pay disgorgement, prejudgment interest, and a civil monetary penalty totaling \$88,780,861 as follows:

- (i) Respondent shall pay to the Commission disgorgement of \$48,473,242 and prejudgment interest of \$307,619, consistent with the provisions of this Subsection B.
- (ii) Within ten days of the entry of this Order, Respondent shall deposit the full amount of disgorgement and prejudgment interest, less monies already distributed to affected RICs, into a segregated account such as a separate bank account ("Distribution Fund") and provide Commission staff with evidence of such deposit in a form acceptable to the Commission staff. Monies already distributed to affected RICs, as described in paragraph III.17 above, shall be deemed satisfied for purposes of deposit to the Distribution Fund. If timely payment into the segregated account is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600.
- (iii) Respondent shall be responsible for administering the Distribution Fund and may hire a professional to assist it in the administration of the distribution. The costs and expenses of administering the Distribution Fund, including any such professional services, shall be borne by Respondent and shall not be paid out of the Distribution Fund.
- (iv) Respondent shall complete the distribution to affected RICs, according to the methodology that it has provided to affected RICs and the Commission staff, within 90 days of the entry of this Order. If Respondent is unable to

distribute or return any portion of the Distribution Fund for any reason, including an inability to locate an affected RIC or any factors beyond Respondent's control, Respondent shall transfer any such undistributed funds to the Commission for transmittal to the United States Treasury in accordance with Section 21F(g)(3) of the Securities Exchange Act of 1934 when the distribution of funds is complete and before the final accounting provided for in Paragraph (vii) of this Subsection B is submitted to the Commission staff.

- (v) Respondent shall, within ten days of the entry of the Order, pay a civil money penalty in the amount of \$40 million (\$40,000,000) to the Securities and Exchange Commission for transfer to the general fund of the United States Treasury, subject to Exchange Act Section 21F(g)(3). If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. § 3717.

Payments ordered pursuant to Paragraphs (iv) and (v) of this Subsection B must be made in one of the following ways:

1. Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;
2. Respondent may make direct payment from a bank account via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofm.htm>; or
3. Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying State Street as Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Amy Gwiazda, Assistant Regional Director, Division of Enforcement, Securities and Exchange Commission, 33 Arch Street, 24th Floor, Boston, MA 02110.

- (vi) The Distribution Fund is a Qualified Settlement Fund (“QSF”) under Section 468B(g) of the Internal Revenue Code (“IRC”), 26 U.S.C. §§ 1.468B.1-1.468B.5. Respondent shall be responsible for any and all tax compliance responsibilities associated with the Distribution Fund, including but not limited to tax obligations resulting from the Distribution Fund’s status as a QSF and the Foreign Account Tax Compliance Act (FATCA), and may retain any professional services necessary. The costs and expenses of tax compliance, including any such professional services shall be borne by Respondent and shall not be paid out of the Distribution Fund.
- (vii) Within 150 days after State Street has completed the distribution to affected RICs, State Street will submit to the Commission staff a final accounting and certification of the distribution. The final accounting and certification will include, but not be limited to: (i) the amount paid to each affected RIC, with the reasonable interest amount, if any, reported separately; (ii) the date of each payment; (iii) the check number or other identifier of the money transferred; (iv) the amount of any returned payment and the date received; (v) a description of any effort to locate a prospective payee whose payment was returned, or to whom payment was not made for any reason; (vi) the total amount of remaining funds, if any, to be forwarded to the Commission for transfer to the United States Treasury; and (vii) an affirmation that Respondent has made payments from the Distribution Fund to affected RICs. The final accounting and certification shall be submitted under a cover letter that identifies Respondent and the file number of these proceedings to Amy Gwiazda, Assistant Regional Director, Division of Enforcement, Securities and Exchange Commission, 33 Arch Street, 24th Floor, Boston, MA 02110. Respondent shall provide any and all supporting documentation for the accounting and certification to the Commission staff upon its request and shall cooperate with any additional requests by the Commission staff in connection with the accounting and certification.
- (viii) The Commission staff may extend the procedural deadlines set forth above for good cause shown. The deadlines shall be counted in calendar days, except if the last day falls on a weekend or federal holiday, the next business day shall be considered to be the last day.

C. Amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondent agrees that in any Related Investor Action, it shall not argue that it is entitled to, nor shall it benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondent’s payment of a civil penalty in this action (“Penalty Offset”). If the court in any Related Investor Action grants such a Penalty Offset, Respondent agrees that it shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission’s counsel in this action and pay the amount of the

Penalty Offset to the Securities and Exchange Commission. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a “Related Investor Action” means a private damages action brought against Respondent by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

By the Commission.

Vanessa A. Countryman
Secretary