

Mortgage-investment flap sings Children's Wish Fund

By: Greg Andrews

NOVEMBER 12, 2007

Indianapolis Business Journal (IN) - The collapse in value of subprime mortgage securities may look like a Wall Street problem, fueling steep writedowns at some of the nation's biggest investment firms and costing some corporate titans their jobs. But recent woes at the Indiana Children's Wish Fund underscore that its tentacles extend all the way to the heartland, even ensnaring the small Indianapolis not-for-profit.

The Children's Wish Fund, which has just four full-time employees, filed an arbitration proceeding this month against Memphis-based Morgan Keegan & Co. and Christopher Herrmann, one of its financial advisers in Indianapolis, after an intermediate-bond fund it put \$222,812 into lost 22 percent of its value, or nearly \$50,000, between late June and late September.

The charity, which grants wishes to terminally ill children, contends Herrmann had indicated that moving working capital from a money market account and certificates of deposit to the bond fund "was completely safe and a smart business decision," according to the arbitration claim.

In fact, according to the claim, the fund "was an incredibly speculative and highly volatile bet on the viability of the U.S. housing market and mortgages created therefrom, including sub-prime mortgages and second lien mortgages." While many bond funds are relatively conservative, this was an entirely different animal, the Indiana Children's Wish Fund says, with more than half its assets in mortgage-related investments as of midyear.

While the loss might sound small, it would be enough for the organization to grant 10 wishes to terminally ill children, said Tom Hargett, a vice president of the charity's board. He's also a local attorney specializing in investor-protection litigation and is representing it in the arbitration.

The 23-year-old charity, which grants 100 wishes a year, has an annual budget of less than \$1 million. Typical gifts range from family trips to Disney World to arranged meetings with celebrities.

Morgan Keegan, a unit of Birmingham, Ala.-based Regions Financial Corp., declined to comment to IBJ. However, in an Oct. 29 letter to the charity's executive director, Terry Ceaser-Hudson, the company said Herrmann denied having characterized the investment as "not subject to risk or a loss in principal." Morgan Keegan also noted that it had provided a prospectus to Ceaser-Hudson that spelled out risks.

Even so, the letter includes an offer to settle for \$14,760-a proposal the Children's Wish Fund has rejected.

In the arbitration claim, Hargett blasts Morgan Keegan for deflecting blame. "Ms. Hudson has been devastated by these losses. The realization of losing ten wishes for terminally ill children is difficult for Ms. Hudson to stomach," he wrote. "Being blamed for this by Morgan Keegan's counsel is simply outrageous."

In addition to recovering losses, Hargett is seeking unspecified punitive damages. The case will be heard by a three-person arbitration panel, the process the brokerage industry uses to resolve disputes with clients. The Indiana Children's Wish Fund also has filed a complaint with the Securities Division of the Indiana Secretary of State's Office.

If Herrmann failed to grasp the risks associated with various mortgage-related securities, he'd be far from alone. Many of the nation's most prominent investment pros loaded up on such securities even as the nation's housing market sputtered and foreclosures rose. Plummeting asset values have caused billions of dollars in write-downs at many investment houses, including Citigroup Inc. and Merrill Lynch—prompting the recent ousters of CEOs at both.

The investment at issue in the Children's Wish Fund dispute is the Regions Morgan Keegan Select Intermediate Bond Fund. It generated annualized returns of 6.1 percent from 2004 to 2006. But this July, the value slid. It's now off more than 35 percent for the year.

In an Aug. 10 market commentary, Jim Kelsoe, portfolio manager for that fund and two others, tried to make sense of the market shift. "During my 20-year career, these are truly unprecedented times," he wrote.

The Indiana Children's Wish Fund bought into the fund June 26, just before the downturn. According to the arbitration claim, Ceaser-Hudson realized the charity was sustaining unacceptable losses when she reviewed the August account statement. She stuck with the fund, according to the claim, after Herrmann told her "he was not concerned because he was confident that the investment would quickly recover in value."

She finally yanked the investment Sept. 27. By then, the value had declined from \$222,812 to \$174,314.