Still more 'discrepancies'

New suit's allegations challenge whatever credibility Beacon Hill might have had left

By Elise Coroneos and the staff

The implosion of Beacon Hill Asset Management LLC, originally portrayed as the result of a hedging strategy gone wrong, is quickly turning into one of the seamier debacles in recent hedge fund memory. While it is clear that hedging—or the lack of hedging—played some role in the unfolding tale, the manager misled its investors for several months.

Since being found out, and removed from the management of the hedge funds where the problems originally arose, Beacon Hill has allegedly attempted to put its own interests ahead of those of investors in other products that it also manages, and misled investors in those products as to the management of the assets.

This just in

In the latest development, which occurred as this edition of MAR/Hedge went to press, Beacon Hill CBO II Ltd and Beacon Hill CBO III Ltd filed suit against Beacon Hill Asset Management LLC on November 19, seeking the removal of Beacon Hill Asset Management as portfolio manager. The plaintiffs represent collateralized bond obligation transactions with total assets of $650 million, which have been managed by Beacon Hill since July 2001 and August 2002, respectively, according to the suit.

The date of the Beacon Hill CBO III Ltd transaction is interesting, if not necessarily significant, because it falls within the range of dates during which the Securities and Exchange Commission, in its separate action, is alleging that Beacon Hill violated the antifraud provisions of the Investment Advisers Act.

That action, filed on November 7, alleged that Beacon Hill published net asset values that materially misrepresented the performance of Beacon Hill Master Ltd, the master fund for its Bristol, Safe Harbor and Milestone Plus Partners LP hedge funds, "for at least the periods ending July 31, August 31 and September 30, 2002."

> "Plaintiffs represent CBO transactions with total assets of $650 million"

On November 15, the SEC was granted a preliminary injunction that gave Beacon Hill 10 days to transfer the funds' remaining assets to a new manager, prohibited redemptions or other distributions without court approval, and required Beacon Hill to "preserve all relevant documents and cooperate fully to enable the new investment manager to perform its duties."

Beacon Hill had already, in a letter to investors on October 18, announced that it was suspending redemptions from the funds.

That letter came 10 days after the first public disclosure of trouble at the funds. On October 8 2002, Beacon Hill told investors in the Bristol and Safe Harbor funds that it had made losses of around 25% in September 2002. The losses, it said, were due to "extraordinary fixed-income market conditions . . . particularly in the final days of September . . . This situation was primarily the result of unprecedented, accelerated mortgage prepayments triggered by historically low interest rates, while US Treasury securities prices rose in reaction to heightened global market and political uncertainty."

That explanation was quickly deemed to be suspect, given that the trends alluded to—increasing Treasury prices and record levels of mortgage refinancings—were already in place well before September 2002.

On October 18, Beacon Hill said that "using a combination of Interactive Data Corporation prices, valuations from our prime broker, and dealer quotations, we have calculated that as of September 30, "the funds' losses were, in fact, approximately 54% from the reported NAV as of August 31.

The firm conceded that "a portion" of the losses occurred before August 31, providing the first real inkling that the problems involved factors other than ugly market realities.

Who's running portfolio?

In the wake of Beacon Hill's original announcement, it was reported that the owner of a managed account at the firm had moved its assets to Ellington Capital Management, which is also where the hedge fund assets have since been transferred.

But according to the CBO suit, Beacon Hill has refused several requests to voluntarily relinquish control of the CBO portfolios despite acknowledging that:

- Negative publicity surrounding Beacon Hill would weaken the value of the securities;
- Its refusal to withdraw as portfolio manager "was not in the best interests of the issuers or the investors, but . . . was in Beacon Hill's self-interest." Jack Barry, Beacon Hill's president, allegedly said that Beacon Hill intended to weather the storm, even if it was at the expense of the CBO issuers and investors; and
- As a direct result of the SEC investigation, at least two Beacon Hill principals nominated as key men in the portfolio management agreements could no longer perform services for the CBO portfolios.

The suit alleges that in conversations on October 25 with representatives of Banc of America, the largest investor in the CBOs, Beacon Hill principal John Irwin said that the SEC was forc- 18▶