VIRGINIA:

IN THE CIRCUIT COURT FOR THE COUNTY OF FAIRFAX

COMMONWEALTH OF VIRGINIA, *et al.* *ex rel.* FX ANALYTICS,	)	
Plaintiffs/Relator,	)	
v.	)	**Civil Case No.: CL-2009-15377**
THE BANK OF NEW YORK MELLON CORPORATION,	)	
Defendant.	)	

COMPLAINT IN INTERVENTION

Plaintiff, the Commonwealth of Virginia (the "Commonwealth"), on its own behalf and on behalf of the Virginia Retirement System ("VRS"), the Fairfax County Employees' Retirement System, the Fairfax County Police Officers Retirement System, the Fairfax County Uniformed Retirement System (collectively, the "Fairfax County Funds"), the Educational Employees' Supplemental Retirement System of Fairfax County ("ERFC"), and the Arlington County Employees' Retirement System ("ACERS"),[1] by and through the Attorney General of the Commonwealth of Virginia (the "Attorney General") and its designated undersigned counsel, against Defendant Bank of New York Mellon Corporation ("BNYM," the "Bank," or "Defendant"),[2] hereby allege the following as their Complaint-in-Intervention pursuant to Va. Code Ann. § 8.01-216.1 *et. seq.*

[1] The Virginia Fraud Against Taxpayers Act defines the "Commonwealth" as the Commonwealth of Virginia, any agency of state government, and any political subdivision of the Commonwealth. Va. Code Ann. § 8.01-216.2. VRS, the Fairfax County Funds, ERFC, and ACERS are referred to collectively herein as the "Virginia Funds" or the "Funds."

[2] All references to BNYM include BNYM's predecessors and subsidiaries including, but not limited to, Bank of New York ("BNY") and Mellon Bank, N.A. ("Mellon").

I. STATEMENT OF THE CASE

1. This Complaint-in-Intervention alleges the facts concerning BNYM's scheme to charge undisclosed markups on foreign currency exchange ("FX") trades to its custodial banking clients, including the Virginia Funds.

2. Public pension funds such as the Virginia Funds regularly buy and sell securities of non-U.S. companies as part of their overall investment strategies.[3] Public pension funds, including the Virginia Funds, need to engage in FX trading because the purchases, sales, dividends, and interest payments on non-U.S. securities are transacted in the national currency of the exchanges on which the securities trade.

3. These public pension funds also commonly retain custodian banks, such as BNYM, to hold and safeguard their assets, to execute and settle securities transactions on the funds' behalf, to generate periodic reports to the funds regarding holdings and transactions, and to perform other services such as conducting FX trading on the funds' behalf.

4. BNYM, as custodian bank for the Virginia Funds knowingly and systematically earned hundreds of millions of dollars by falsely presenting to those clients reported exchange rates for certain "standing-instruction" FX transfers of foreign currencies conducted internally between BNYM's own FX trading desks and its transaction desks.

5. The FX rates that BNYM reported to the Virginia Funds for such "standing-instruction" transfers bore no relation to (i) the rate BNYM paid or received for the foreign currency, (ii) the FX rate at the time an instruction was given, or (iii) the FX rate at the

[3] Public pension funds, including the Virginia Funds, may opt to conduct their investments in whole or in part through outside agents known as investment managers ("Outside IMs"). Such pension funds, and, in this case in particular, VRS, sometimes have their own employees act as internal investment managers ("Internal IMs"). As used in this Complaint-in-Intervention, the Virginia Funds' investments and FX transactions may have been conducted by the Virginia Funds directly or through their Outside or Internal IMs, acting on the funds' behalf. For clarity, and unless the context requires distinction, all references to Outside or Internal IMs will be to "IMs."

time of BNYM's internal transfer of currency to or from its inventory to or from the Virginia Funds' accounts. In reality, BNYM assigned to the Virginia Funds, at *the end* of the trading day, self-selected FX rates at the very extremes of the range of FX trades for that day.[4]

6. In addition to pricing FX at the extremes of the range of the day, BNYM's scheme also involved a procedure to ensure that the Virginia Funds would not discover that the Bank assigned fictitious FX rates to them at the end of the day. Specifically, BNYM's internal policy was to assign those false FX prices so that they fell within an artificial range of FX prices that the Bank established each day before 9:00 a.m. BNYM offered this artificial, pre-determined range only to the Virginia Funds' Outside IMs, but not the Funds themselves. The Virginia Funds were unaware that their Outside IMs received this pre-determined range, and were therefore entirely unaware of its existence.

7. Moreover, because BNYM established this artificial range of FX prices shortly after the outset of the trading day, neither the Bank nor the IMs could know what the FX rates for the day would be, nor what any particular custodial client's standing-instruction FX trading requirements for that day might be. Unsurprisingly, BNYM set the range in such a way that it, absent highly unusual circumstances, would be much broader than the eventual, actual range of the day. This virtually assured BNYM that the FX rates it assigned to its custodial clients at the extremes of the actual range of the day would nonetheless fit within the artificial, pre-determined range.

8. By assigning these false FX rates, BNYM earned unwarranted income at the Commonwealth's expense. BNYM simply charged those clients more for FX purchases, and credited them less for FX sales, than (i) BNYM paid or received for the foreign currency, (ii) the

[4] "Range of the day," discussed in greater detail below, is a recognized industry term describing the difference between the high rate and low rate for the exchange of a given currency pair during the course of the FX trading day.

FX rate at the time an instruction was given, or (iii) the FX rate at the time of BNYM's internal transfer of currency to or from its inventory to or from the Virginia Funds' accounts.

9. In order to hide its self-serving acts, BNYM presented to its custodial clients, including the Virginia Funds, false records, reports, and statements. These reflected falsified FX rates that BNYM assigned to the Virginia Funds at the extremes of the range of the day. Notwithstanding the fictitious nature of the assigned FX rates, BNYM reported to the Virginia Funds that those rates instead represented "Local Base Price," "Local Base Cost," "Local Base Amount," "Book Value Base," "Base Market Value," "Settle Price," "Rate," "Base Cost," "Currency Cost in Base," "Base Exchange Rate," "Cost of Base Currency," or "Cost of Local Currency."

10. These terms presented to the Commonwealth as the prices for each standing-instruction FX trade performed by BNYM were false because of the material information they did not convey. Indeed, those terms did not mean, and could not have meant, that BNYM had assigned prices to FX transactions (i) at the extremes of the actual range of the day, and (ii) within an artificial, pre-determined range of FX prices, of which the Virginia Funds were unaware.

11. Rather, those terms gave recipients the impression that the FX prices presented for standing-instruction trades were reasonably related to either (i) the price BNYM paid or received for the particular foreign currency, (ii) the FX rate at the time a standing-instruction was given, or (iii) the FX rate at the time of BNYM's internal transfer of currency to or from its inventory to or from the Virginia Funds' accounts.

12. These deceptive practices reflected a well thought-out scheme emanating from the highest reaches of BNYM's senior management. Internal BNYM communications reveal that high-ranking officers at the Bank were aware of and participated in the deception.

13. One e-mail, dated February 8, 2008, from Jorge Rodriguez, BNYM's Executive Vice President of Global Sales and a Managing Director at the Bank's New York City offices, explained to a number of other high-ranking New York-based BNYM executives, including Richard Mahoney, Executive Vice President of Global Markets, that the "pricing advantages" of BNYM's FX pricing scheme would "disappear" if the Bank's custodial clients achieved "full transparency."

14. Such "full transparency" would permit custodial banking clients to understand the difference between what BNYM reported and (i) what BNYM paid or received for the foreign currency, (ii) the FX rate at the time an instruction was given, or (iii) the FX rate at the time of BNYM's internal transfer of currency to or from its inventory to or from the Virginia Funds' accounts.

15. Specifically, Mr. Rodriguez noted that if BNYM were required to provide "full transparency" in its reports to its custodial clients, their increased "ability to carefully monitor each and every trade at the time of execution" would "reduce[] margins dramatically."

16. BNYM's scheme guaranteed that its custodial clients, including the Virginia Funds, were unable to monitor any aspects of the Bank's practice of assigning false FX rates. In fact, the procedures under which BNYM stated that it would conduct these standing-instruction FX trades by assigning FX rates within a pre-determined range were instituted through undisclosed side "contracts" executed with the Virginia Funds' Outside IMs. Nothing, however, in BNYM's agreements with the Virginia Funds permitted it to enter into such "contracts."

17. These side "contracts" unilaterally changed the nature of the relationships between BNYM and the Virginia Funds. Despite the fact that none of the Virginia Funds' agreements contained any language naming BNYM as a "principal" in standing-instruction FX trading, the side contracts that BNYM executed with the Outside IMs purported to create just such an undisclosed "principal" relationship between BNYM and the Virginia Funds in connection with standing-instruction FX trades.

18. As set forth in greater detail below, BNYM had a fiduciary relationship with the Fairfax County Funds, ERFC, and ACERS pursuant to the terms of their custodian contracts. With respect to VRS, BNYM had a contractual duty to act with "care, skill, prudence and diligence under the circumstances then prevailing that a prudent [custodian bank] and familiar with such matters would use in the conduct of an enterprise of like character and with like aims and responsibilities." In VRS' case, BNYM's role as a prudent custodial bank included management of billions of dollars of taxpayer-funded cash and securities, and possession of highly confidential financial information.

19. Despite the very high standard of care imposed upon BNYM by its various contracts with the Virginia Funds, BNYM attempted to alter its duties to the Virginia Funds without disclosure of the terms, substance, or existence of these side agreements.

20. In standing-instruction trades, the custodian bank controls all aspects of the transaction on its clients' behalf, including the time and price of thereof. Because, by definition, the client relinquishes all control over the transaction, the custodian bank is in a superior position to the client, and the client must rely on and trust its custodian bank to act in its best interests. In fact, the bank is in total control of (i) the timing and structure of the transaction that results in

what it pays for the FX, (ii) what the custodial client is charged, and (iii) the client funds that are used to pay the custodial bank.

21. Here, BNYM had actual custody of cash and securities belonging to the Virginia Funds and, with respect to the false FX charges at issue, it debited or credited the Virginia Funds' accounts, and then reported the transactions to the Virginia Funds after the false transactions were completed.

22. BNYM capitalized on its position of trust and reliance to carry out its deceptive scheme. The Bank's method was relatively simple:

(a) Throughout the course of the trading day, BNYM executed FX trades for its own account and/or the account of its spot traders on its own trading desks on the interbank market.

(b) When custodial clients, such as the Virginia Funds, required a standing-instruction FX trade, BNYM would not necessarily conduct a trade. Instead, BNYM would aggregate, on a currency-by-currency basis, the standing-instruction trades of all of its custodial clients.

(c) Subsequently, BNYM would arrange an internal currency transfer between its FX trading desk and its transaction group. An internal accounting entry, sometimes known as a "CMS Offset," would be recorded based upon the price of the currency at issue at the time of the internal currency transfer.

(d) BNYM presented to its custodial clients, including the Virginia Funds, a price that it assigned at the extremes of the actual range of the day. This assigned price was different from the price (i) actually paid or received for FX trades, (ii) of the currency at issue at the time of the internal currency transfer, and

(iii) at the time that the transaction group learned of a custodial client's FX trade requirement.

(e) Those false, assigned prices reported to custodial clients, including the Virginia Funds, were always to BNYM's exclusive benefit, at the expense of its custodial banking clients.

23. The spread between the false FX rates BNYM reported to the Virginia Funds and the price (i) actually paid or received for FX trades, (ii) of the currency at issue at the time of the internal currency transfer, or (iii) the price at the time that the transaction group learned of a custodial client's FX trade requirement, generated for BNYM greater amounts of income than it was entitled to pursuant to its negotiated agreements with the Virginia Funds. BNYM earned this excessive income entirely at the expense of the Virginia Funds.

24. Additionally, by (i) assigning and reporting a false FX rate that fell at the extremes of the range of the day, but (ii) choosing not to report the actual price at which it executed standing-instruction FX transactions, (iii) choosing not to report that it conducted an internal currency transfer, and (iv) failing to report the time of day that it executed any particular FX transaction, BNYM was able to hide its conduct from scrutiny by the Virginia Funds. Through this deception, BNYM was therefore able to present a false price to the Commonwealth for each of the more than 73,000 standing-instruction trades at issue in this case.

25. Further compounding the harm was BNYM's presentment of flat-rate fees to the Virginia Funds. The Bank made false representations that standing-instruction FX trades were either free of charge, or were included within the flat-rate custodial fees it charged to the Funds. In some instances (discussed in greater detail below), the contracts between BNYM and the

Virginia Funds went so far as to state expressly that there would be no charge for standing-instruction FX trading conducted through BNYM.

26. Moreover, BNYM used its company website to represent to all of its custodial banking clients, including the Virginia Funds, that standing-instruction FX trading was conducted "free of charge," and the statements on its website confirm other non-written representations made by BNYM officials.

27. Accordingly, and because the assigned and reported false standing-instruction FX rates always appeared to be within the *actual* range of FX prices for the day (albeit at the extreme end), there was no way for the Virginia Funds to reasonably determine, or even suspect, that BNYM was secretly assigning and reporting more than what (i) BNYM paid or received for the foreign currency, (ii) the FX rate at the time an instruction was given, or (iii) the FX rate at the time of BNYM's internal transfer of currency to or from its inventory to or from the Virginia Funds' accounts.

28. Therefore, the Virginia Funds could not reasonably have discovered BNYM's deceptive acts and practices concerning FX trading. BNYM executed hundreds, if not thousands, of FX trades on behalf of the Virginia Funds every month. The reports BNYM presented to the Virginia Funds did not distinguish between standing-instruction and negotiated trades and showed only the rates that BNYM charged for its FX trades. Moreover, the reports did not include any indication of the actual time of the day that the trade was executed (known as "time-stamps").

29. Every time BNYM completed a deceptive standing-instruction FX transaction, presenting to the Commonwealth either a falsely inflated charge (for FX purchases), or a falsely deflated credit (for FX sales), it thereby submitted a false claim to the Commonwealth, in

violation of the Commonwealth's Fraud Against Taxpayers Act, Va. Code Ann. § 8.01-216.1 *et seq.* ("FATA").

II. PARTIES

A. Plaintiff Commonwealth of Virginia

30. The Commonwealth, pursuant to Va. Code Ann. § 8.01-216.2, brings this Complaint-in-Intervention on its own behalf and on behalf of those agencies of state government, political subdivisions, and divisions of political subdivisions, as more fully set forth herein.

B. Defendant Bank of New York Mellon Corp.

31. The Bank of New York Mellon Corporation is the parent corporation resulting from the July 1, 2007 merger of the Bank of New York Company, Inc. with Mellon Financial Corporation.[5] BNYM's corporate headquarters is located at One Wall Street, New York, New York 10286. As of the second quarter of 2011, the BNYM maintained $26.3 trillion under custody and administration, with $1.2 trillion under management.

32. In 2010, BNYM's FX and other trading activity revenue totaled $886 million. The totals for the same activities in the immediately proceeding years were $1.0 billion in 2009 and a record $1.5 billion in 2008. For the years 2002 to 2010, BNYM and its predecessor entities have reported approximately $7 billion in FX trading revenue. The great majority of these revenues came directly at the expense of public pension funds such as the Virginia Funds.

33. At all relevant times, BNYM transacted business in the Commonwealth of Virginia by, among other things, entering into contracts in the Commonwealth to serve custodial

[5] By July 1, 2008, the Bank had consolidated and renamed its principal bank and trust company into two banks: The Bank of New York Mellon, and BNYM, National Association. These entities, along with many others, are primary subsidiaries of the parent corporation, The Bank of New York Corporation. BNYM assumed the liabilities of the corporations merged into it. N.Y. Banking Law § 602(2) (Consol.). As referred to herein, therefore, general references to BNYM include the merged corporation as well as its constituent, individual predecessor corporations and subsidiaries unless otherwise noted. Bank of New York and Mellon Bank merged to form BNYM. The effective date of the merger was July 1, 2007. References to "Mellon legacy" and "BNY legacy" herein refer to the specific post-merger operations of the individual subsidiaries of the new parent, BNYM.

banking clients, including the Virginia Funds, as custodian bank and by controlling property of the Commonwealth.

34. Prior to changing the substance of the message on its website following the filing of the California Action on October 20, 2009, BNYM represented to all of its custodial banking clients within the Commonwealth, including the Virginia Funds, that standing-instruction FX trades were conducted "free of charge."

III. THE VIRGINIA FUNDS

A. Virginia Retirement System

35. VRS is a body corporate and political subdivision of the Commonwealth of Virginia, pursuant to Va. Code Ann. §§ 51.1-124.3 and -124.4, and is headquartered in Richmond, Virginia.

36. VRS administers a defined benefit plan, a group life insurance plan, a deferred compensation plan, and a cash match plan for the Commonwealth's public sector employees, as well as an optional retirement plan for selected employees, and the Virginia Sickness and Disability Program for state employees.

37. VRS currently administers benefits and services for approximately 600,000 members, retirees and beneficiaries. As of March 31, 2011, VRS's investment portfolio totaled $54.3 billion, including approximately $17 billion of which was invested in non-United States markets, or 31% of its total portfolio.

38. VRS has been a custodian banking client of BNYM, or its predecessor entities, pursuant to custodian banking agreements, since 1988.

B. The Fairfax County Funds

39. Fairfax County, Virginia is a political sub-division of the Commonwealth of Virginia.

1. The Fairfax County Employees' Retirement System

40. As authorized and required by state law, the governing body of Fairfax County, its Board of Supervisors, by ordinance, has established its Employees' Retirement System to provide retirement benefits for the classes of employees set forth in the ordinance. The Board of Supervisors, by ordinance, has created a Board of Trustees for the Fairfax County Employees' Retirement System and has vested in it the general administration and responsibility for the proper operation of the Fairfax County Employees' Retirement System and for making effective the provisions of the ordinance, including, but not limited to, the employment and paying out of the System's funds for all services, as shall be required, including, but not limited to custodial bank services, and the investment and re-investment of the funds of the Fairfax County Employees' Retirement System.

41. The Fairfax County Employees' Retirement System is a cost-sharing, multiple-employer, public employee retirement system providing defined benefit pension plan coverage to full-time and certain part-time Fairfax County and Fairfax County public schools' employees not covered by the Fairfax County Police Officers Retirement System, the Fairfax County Uniformed Retirement System, the ERFC or VRS.

42. Established in 1955, as of July 1, 2010, the System's membership consisted of 20,859 active and retiree members. As of June 30, 2010, the System had $2.5 billion in net assets. As of June 30, 2010, the System had a total of $243 million invested in securities denominated in foreign currencies, constituting 9.8% of the System's total investments.

2. The Fairfax County Police Officers Retirement System

43. As authorized and required by state law, the governing body of Fairfax County, its Board of Supervisors, by ordinance, has established its Police Officers Retirement System to provide retirement benefits for the classes of employees set forth in the ordinance. The Board of

Supervisors, by ordinance, has created a Board of Trustees for the Fairfax County Police Officers Retirement System and has vested in it the general administration and responsibility for the proper operation of the Fairfax County Police Officers Retirement System and for making effective the provisions of the ordinance, including, but not limited to, the employment and paying out of the System's funds for all services, as shall be required, including, but not limited to custodial bank services, and the investment and re-investment of the funds of the Fairfax County Police Officers Retirement System.

44. The Fairfax County Police Officers Retirement System was created under authority granted by Chapter 303 of the Acts of Assembly in 1944 to provide defined benefit pension plan coverage for sworn full-time law enforcement officers of the Fairfax County Police Department.

45. As of July 1, 2010, membership in the System consisted of 2,187 active and retiree members. As of June 30, 2010, the System held $836 million in net assets, including $64 million invested in securities denominated in foreign currencies, constituting 7.6% of the System's total investments.

3. The Fairfax County Uniformed Retirement System

46. As authorized and required by state law, the governing body of Fairfax County, its Board of Supervisors, by ordinance, has established its Uniformed Retirement System to provide retirement benefits for the classes of employees set forth in the ordinance. The Board of Supervisors, by ordinance, has created a Board of Trustees for the Fairfax County Uniformed Retirement System and has vested in it the general administration and responsibility for the proper operation of the Fairfax County Uniformed Retirement System and for making effective the provisions of the ordinance, including, but not limited to, the employment and paying out of the System's funds for all services, as shall be required, including, but not limited to custodial

bank services, and the investment and re-investment of the funds of the Fairfax County Uniformed Retirement System.

47. The Fairfax County Uniformed Retirement System was established in 1974 as a public employee retirement system providing defined benefit pension plan coverage for uniformed or sworn employees of the Fire and Rescue Department, helicopter pilots, the Sheriff's Department, the animal control division, and certain park police officers. In 2005, membership was extended to employees in non-administrative positions of the Department of Public Safety Communications, formerly included in the Fairfax County Employees' Retirement System.

48. As of July 1, 2010, the System consisted of 3,016 active and retiree members. Also as of June 30, 2010, the System's net assets totaled $991 million, including $170 million invested in securities denominated in foreign currencies, or 17.2% of the System's total investments.

49. The Fairfax County Employees' Retirement System, the Fairfax County Police Officers Retirement System, and the Fairfax County Uniformed Retirement System (collectively, the "Fairfax County Funds") have been custodial banking clients of BNYM, or its predecessor entities, pursuant to custodian banking contracts, since 2002.

C. The Educational Employees' Supplemental Retirement System of Fairfax County

50. The ERFC is a retirement system established by the Fairfax County Board of Supervisors in Fairfax County Code § 3-4-1, pursuant to what is now Va. Code Ann. § 51.1-801.

51. In creating the system, the Fairfax County Board of Supervisors delegated its authority to administer the system to a Board of Trustees, Fairfax County Code § 3-4-2. That delegation specifically included "the right to prosecute, defend, compromise, settle, abandon, or

adjust by arbitration or otherwise any actions, suits, proceedings, disputes, or claims relating to the retirement system." *Id.* § 3-4-6(a)(4).

52. The ERFC is a defined benefit plan qualified under 401(a) of the Internal Revenue Code. Funding is provided in part by employer and member contributions to the plan; income earned through investment of the plan's assets provides the majority of funding. Established in 1973, the ERFC's membership includes retirees, deferred vested and active Fairfax County Public Schools personnel who are employed full-time in monthly paid educational, administrative, and support staff positions.

53. As of December 31, 2010, the ERFC had 31,941 members. As of June 30, 2010, ERFC held $1.6 billion in net assets, approximately $219 million, or 14% of which are invested in securities denominated in foreign currencies.

54. The ERFC has been a custodial banking client of BNYM, or its predecessor entities, pursuant to custodian banking contracts, since 1995.

D. <u>The Arlington County Employees Retirement System</u>

55. ACERS is a political subdivision of the Commonwealth of Virginia based in Arlington, Virginia.

56. ACERS manages the investment of Arlington County's retirement fund and distributes fund assets in the form of benefits to retired county employees. ACERS was established as a defined benefit plan under authority of an act of the General Assembly of Virginia, and its provisions are memorialized in Chapters 21, 35, and 46 of the Arlington County Code. As of July 1, 2009, the System's membership consisted of 7,361 members, and by the end of the fiscal year 2010, ACERS had $1.3 billion net assets. A significant percentage of ACERS net assets are invested in securities denominated in foreign currencies.

57. ACERS has been a custodial banking client of BNYM, or its predecessor entities, pursuant to custodian banking contracts, since 1995.

IV. THE RELATOR

58. Much of the conduct in question was brought to the Commonwealth's attention by FX Analytics, the named Relator in *Commonwealth of Virginia, ex rel. FX Analytics v. The Bank Of New York Mellon Corporation*, Case No. CL-2009-15377 (the "Qui Tam Action" or "Qui Tam Complaint").

59. The Relator possesses deep and sophisticated knowledge and personal experience in BNYM's businesses, particularly regarding FX. In addition, the Relator has had extensive personal contact with the employees and executives of BNYM who have committed the alleged FATA offenses, as presented below. Furthermore, the Relator possesses first-hand knowledge to support and establish the charges asserted herein.

60. The Relator was employed in the FX trading department at BNYM in Pittsburgh, Pennsylvania. The Relator has more than 20 years of experience in foreign exchange currency trading.

61. The Relator worked at BNYM (and previously at Mellon Bank) for more than 10 years. Throughout that time, the Relator dealt directly with spot traders. The Relator observed or participated in reporting on interbank issues and developments and broader foreign exchange matters to the executive level of the Bank.

62. The Relator observed BNYM's FX trading for its custodial clients and learned directly that the FX scheme described herein was orchestrated and demanded by the senior executive staff of the Bank.

V. JURISDICTION AND VENUE

63. BNYM entered into contracts with the Commonwealth, and its state agencies, including political subdivisions and departments of political subdivisions located in Fairfax County.

64. Pursuant to its contractual relationships, and for the reasons stated herein, BNYM engaged in conduct directed at the Commonwealth and residents of the Commonwealth, and performed a substantial portion of its duties under the contracts at issue in Fairfax County.

65. Thus, a part of this cause of action arose in Fairfax County, in accordance with Va. Code Ann. § 8.01-262.

66. This Court has jurisdiction over the subject matter and parties to this action and is a proper venue for this action.

VI. SUBSTANTIVE ALLEGATIONS

A. The Nature of FX Trading

1. The Increasing Necessity of FX Trading in a Global Investment Portfolio

67. During the past decade, in order to meet their investment and funding objectives, U.S.-based institutional investors, including public pension funds such as the Virginia Funds, have found it increasingly necessary to enter the overseas securities markets and expand the global scope of their investment portfolios.

68. Institutional investors that buy and sell foreign securities, such as the Virginia Funds, must engage in FX trading because the purchases, sales, dividends, and interest payments are all transacted in the national currency of the exchange on which the foreign security traded.

69. If, for example, a public pension fund wishes to buy shares of stock in a German company that trades on a German securities exchange, that fund must sell U.S. dollars and

purchase euros in order to buy those shares. Further, any cash dividends paid on that German stock will be denominated in euros. To "repatriate" those dividends, the public pension fund must sell the euros received and purchase dollars. Accordingly, FX transactions are the means for converting U.S. dollars into foreign currency and vice versa.

2. The FX Trading Day

70. FX trading takes place around the world on a nearly 24-hour cycle, five-and-a-half days a week. The official FX trading week begins at 7:00 a.m. New Zealand time on Monday, with each subsequent trading day ending at 5:00 p.m. New York City time.

71. For each currency bought and sold during the course of the FX trading day, there will necessarily be a high trade and a low trade, with all other trades falling somewhere in between. This information is determined through trade data monitored and tracked by proprietary services such as the Electronic Brokerage System ("EBS") and Reuters.

72. The difference between the high trade and the low trade is called the "range of the day." By way of example, assume 100 FX trades in euros-for-dollars (EUR-USD) during the course of one trading day. If the lowest rate trade occurred at $1.33 to buy €1.00, and the highest rate trade occurred at $1.35 to buy €1.00, the range of the day would be $1.33-$1.35.

3. Negotiated vs. Non-Negotiated FX Trades

73. BNYM gave its custodial banking clients, including the Virginia Funds, a choice with respect to the manner in which FX trades would be conducted. In a "negotiated" FX trade made through BNYM, a custodial client or its Outside IM personally communicates the trade information to a BNYM FX trader. The BNYM FX trader then quotes a rate, which is either accepted or rejected. If accepted, BNYM executes the FX trade at the agreed-upon price, which could include a modest mark-up; one that is clearly disclosed and agreed to by the client (hence, the term "negotiated" trade).

74. A non-negotiated or "standing-instruction" FX trade, however, is essentially the opposite of a negotiated trade. There is no arm's-length negotiation of the price between the parties to the transaction. With standing-instruction trades, custodial clients do not negotiate rates with BNYM, nor does BNYM quote rates. Instead, as the name "standing-instruction" suggests, custodial clients may not even need to request an FX trade. Especially in circumstances of smaller trades, such as small dividend or interest repatriations, BNYM simply executes the necessary trade on the custodial banking client's behalf.

75. In other words, the Bank sits on both sides of the transaction when executing and pricing standing-instruction trades. BNYM remains in total control of both the transaction and the custodial banking client. The Virginia Funds often requested that BNYM handle certain FX transactions through standing-instruction and, therefore, had to trust and rely upon BNYM to engage in those transactions fairly and accurately.

76. BNYM had procedures to conduct standing-instruction FX trades that were unknown to the Virginia Funds, although communicated to some of their Outside IMs. These procedures explained that BNYM would assign FX rates that fell within a pre-determined range, set before 9:00 am each day, when no one could know what the FX prices for the day would be, nor what FX trading requirements would arise as the day progressed.

77. Moreover, at no time did BNYM inform the Virginia Funds or their Outside IMs that while the Bank assigned FX rates to the Virginia Funds that fell *within* the artificial range, these FX rates always fell at the very *extremes* of the actual range of the day.

78. Most importantly, BNYM never informed the Virginia Funds of side agreements that it made with some of their Outside IMs. Nor did BNYM inform the Virginia Funds that

these side agreements purported to change the nature of its relationship with the Funds to one in which BNYM would be a "principal."

79. Additionally, the Virginia Funds reasonably expected that standing-instruction FX trades would have no mark-ups or fees. That expectation was based upon, among other things, (i) the significant annual fees the Virginia Funds paid BNYM to compensate the Bank for its services as custodian for the Virginia Funds' assets, which, (ii) pursuant to contract, did not include standing-instruction FX trading as a service for which BNYM was permitted to charge a fee or mark-up above the agreed-to flat annual fee; and (iii) statements by BNYM in formal responses to certain RFPs that there would be no charge for FX transactions executed internally by BNYM.

80. Furthermore, prior to October 2009—when BNYM changed the substance of its representations on its website following the California Attorney General's intervention in *California v. State Street*, a *qui tam* action against another large custodian bank, State Street Bank—BNYM's website represented that it conducted standing-instruction FX trading for its custodial customers "***free of charge***." (emphasis added).

81. Indeed, each contract between BNYM and any of the Virginia Funds contained a schedule of permissible fees, none of which included fees for standing-instruction FX trades.

B. BNYM's Deceptive Scheme Overcharged the Virginia Funds and the Commonwealth for Standing-Instruction FX Trades

1. The Particulars of BNYM's Custodial Banking Relationship With Each of its Clients Was Based in Part on the Potential Income Standing-Instruction FX Trading Would Generate

82. According to the Relator, standing-instruction FX trading provided a constant stream of revenue BNYM "credit" which was shared between the Bank's "FX Group" and "Custody Group."

83. When competing for custodial banking clients, BNYM management consulted with the FX group to estimate the income that could be earned if Defendants were retained to execute the prospective client's FX trades. Among the factors BNYM considered when making its pricing proposals to clients were the amount of international investments it would have under management with the client, and the percentage of trades it would conduct for the client by means of standing-instruction. After the FX group formulated a conservative estimate of the FX income potential of each prospective custodial banking client, the BNYM executives responsible for custodial banking incorporated that estimate into the flat fee pricing structure. None of this was known to the Virginia Funds.

2. BNYM Manipulated its Custodial Banking Clients' Standing-Instruction FX Trades for its Own Profit

84. BNYM generated undisclosed income from its standing-instruction FX trades by assigning and reporting to its clients an exchange rate significantly higher (for purchases) or lower (for sales) than the actual rate at the time of the internal currency transfers referred to in ¶¶ 4, 22, and which had no relationship to any particular FX trade in the interbank market.

85. This deception was a zero-sum game. BNYM's undisclosed income in these standing-instruction FX transactions mirrored commensurately undisclosed expenses for its custodial banking clients, including the Virginia Funds. That is, any income that BNYM obtained by charging its clients an amount higher or lower than what (i) BNYM paid or received for the foreign currency, (ii) the FX rate at the time an instruction was given, or (iii) the FX rate at the time of BNYM's internal transfer of currency to or from its inventory to or from the Virginia Funds' accounts represented an equivalent expense to those clients—and thus an extra fee or charge that had not been negotiated or disclosed.

86. Contrary to what the Virginia Funds believed, BNYM's FX traders rarely, if ever, assigned to its custodial banking clients the FX rate actually obtained by BNYM at the time of a trade on behalf of that client. Instead, the FX trade orders were generally filled once a day out of the Bank's "inventory" of currencies, and BNYM assigned the rates that it ultimately reported to, and charged or credited its standing-instruction FX trade clients.

87. These assigned rates corresponded to the extreme high or extreme low prices of the day without regard to the price BNYM actually paid (or received) for foreign currency, the price at the moment of the internal currency transfer, or the FX rate of the time of the standing-instruction trade request.

88. As will be discussed in greater detail below, this deception hinged on four general procedures:

(a) First, because BNYM aggregated many clients' trade requests when it conducted standing-instruction FX transactions, BNYM's transaction desk disregarded the actual time of its standing-instruction custodial clients' FX trade requests (and therefore, the actual exchange rate at that time), and instead allowed all requests for particular currencies to accumulate in their respective currency pair groupings.

(b) Second, once reaching an arbitrary cut-off time (usually 1:30 p.m. Eastern time), BNYM's transaction desk executed one internal currency transfer with the bank's FX trading desk for that one particular currency (this step was repeated for all relevant currencies on every FX trading day). The true cost to BNYM for that FX transaction was whatever rate the FX trader received or

paid—at whatever time the trader actually executed the purchase or sale of the relevant currency.

(c) Third, notwithstanding the true rate for any particular currency, or the rate at the time that the BNYM transaction desk learned of the custodial client's FX trade requirement, BNYM's transaction desk then waited until the end of the FX trading day to determine the point when the actual range of the day was widest, thus offering the bank the greatest possible margin. Almost without exception, these extremes of the range of the day fell within the pre-determined, artificial range of FX prices offered to custodial clients' Outside IMs each day before 9:00 a.m.

(d) Fourth, and finally, after making that determination, BNYM's transaction desk personnel then chose and assigned to its clients the most profitable FX rate to report, regardless of what (i) BNYM paid or received for the foreign currency, (ii) the FX rate at the time an instruction was given, or (iii) the FX rate at the time of BNYM's internal transfer of currency to or from its inventory to or from the Virginia Funds' accounts. Because BNYM looked for the point at which that particular currency reached its high or low point of the actual range of the day, the Bank maximally increased the spread between the true exchange rate and the rate BNYM reported to its custodial banking clients.

89. It was that spread between the false FX rates BNYM assigned and reported to its custodial banking clients (the high end of the range for purchases, or the low end of the range for sales) and the actual FX rate at which BNYM executed the internal accounting transfer that

generated the tremendous amount of undisclosed income to BNYM and expense to the Virginia Funds from the deceptive scheme.

3. A Step-by-Step Description of How BNYM's Transaction Desks Assigned The FX Rates the Bank Charged or Credited to its Custodial Banking Clients

90. According to the Relator, the following paragraphs describe step-by-step how standing-instruction FX transactions were processed and executed at BNYM.

91. A custodial banking client, or that client's IM, initiated a foreign asset transaction. Nearly all were purchases or sales of securities or repatriations of dividend or interest payments.

92. Upon learning of the custodial banking client's need for that foreign asset transaction, BNYM's Asset Servicing Group ("ASG") processed the transaction, thereby generating the need to buy or sell foreign currency to complete the transaction.

93. The ASG then communicated the resulting FX trading requirement to BNYM's FX department, in the form of an Electronic Trade Delivery notice ("ETD"), though this communication could also have been via fax or e-mail.

94. The ASG entered the ETD communication into an electronic pipeline known as CMS, believed to be an abbreviation for the "Cash Management System."[6]

95. CMS then sent the standing-instruction FX trade order to BNYM's FX Trading System, known as "Charlie." Charlie aggregate trades as they are entered into their respective currency pairs. At or about 1:30 p.m. each day, the Transaction Desk looked at the aggregate data from Charlie and determined the need to buy or sell a particular currency.

96. At the legacy Mellon desk in Pittsburgh, the Transaction Desk was manned by Sue Pfister, Paul Park, and Phyllis Bertok. They were responsible, respectively, for (i) Euro (Ms. Pfister); (ii) Swiss Francs, British Pounds, South African Rand, and Scandinavian currencies

[6] The equivalent system at BNY was called "GSP." This name is still used at legacy BNY.

(Mr. Park); and (iii) Canadian Dollar, Japanese Yen, Australian Dollar, New Zealand Dollar, and minor Asian currencies (Ms. Bertok). The Pittsburgh Transaction Desk handled emerging market currencies as a group.

97. BNYM's Pittsburgh Transaction Desk usually set 1:30 p.m. Eastern time as a cut-off for its FX trade order accumulation. Once the FX trade order accumulation deadline had passed, Pittsburgh Transaction Desk personnel would view the aggregate total and print out all of the trades.

98. Then, the Pittsburgh Transaction Desk conducted an internal currency transfer[7] with whichever of its FX traders conducted the intrabank transactions for that particular currency.

99. Well after BNYM's FX traders executed that internal currency transfer, Pittsburgh Transaction Desk personnel then assigned a false FX trade rate (higher rates for buy orders, or lower rates for sales) that they chose by looking back to the extremes of the range of the day. With very few exceptions, the *only* limitation BNYM's Pittsburgh Transaction Desk ever placed on this false assigning of prices was the high and low rates for the day.

100. The New York Transaction Desk did not employ the same strict cut-off time of 1:30 p.m. that Pittsburgh's Transaction Desk used, but instead often randomly priced FX deals as they came in. If standing-instruction FX trade requests remained unexecuted late in the trading day, William Samela, a Managing Director who also functioned as BNYM's New York office's chief FX dealer, often walked around the New York Transaction Desk telling FX traders what currency exchanges needed to be executed.

---

[7] These internal currency transfers were sometimes referred-to as "trades," but in reality they were mere accounting notations on the Bank's books.

101. According to the Relator, at times the New York Transaction Desk also applied false FX rates that fell completely outside the actual range of the day.

102. Every day, at or around 2:30 p.m., when BNYM began to choose the FX rates it would falsely report to its standing-instruction FX trade clients, the Pittsburgh Transaction Desk called the New York Transaction Desk to synchronize the high and low ranges for each currency pair. BNYM conducted this call to prevent discrepancies between each Transaction Desk's operations so that clients would not be suspicious should they see two different transaction rates for the same currency pairs.

103. An April 1, 2009 e-mail from A.J. Quitadamo, BNYM Senior Vice President of New Business Development, to Kevin Lawrie, the Senior Vice President of Foreign Exchange Trading at BNYM's Pittsburgh desk; John Cipriani, Managing Director of Foreign Exchange Planning and Execution; and Mr. Samela, explained these procedures:

> Nothing in our procedure (attached) precludes ***late day pricing*** of [standing-instruction] trades. Pricing is however subject to following:
>
> - Rates must be within morning band posted on-line;[8]
> - ***Client [standing-instruction] trades must be priced similarly in NY and Pitts[burgh]***;
> - Rates must be within +/- 3% of "current" interbank market rates (NY and Pitts need to measure this similarly)

(Emphasis added.)

104. Standing-instruction FX trade clients, including the Virginia Funds, were presented with and received from BNYM reports listing the FX trades by trade date, trade amount, and the falsified trade price. Furthermore, in order to hide from the Virginia Funds the falsity of the rates, these reports never contained time-stamps, a statement of the income earned

[8] The Commonwealth infers that the reference to the "morning band" is to the artificial range of the day set each morning before 9:00 a.m.

by BNYM, the actual FX price, the internal currency transfer rate, or any other fact or data point that would lead standing-instruction FX trade clients to understand the true amount of income to BNYM and the true amount of expense to the client.

105. For example, in the transaction reports that BNYM made available to VRS, the tens of thousands of reported FX rates fell under category heads such as "Local Base," "Amount Local," "Book Value Base," "Base Exchange Rate," "Cost of Base Currency," and "Cost of Local Currency."

106. BNYM's reports to the Fairfax County Funds similarly described the FX trade rates under the terms "price," "cost" and "amount," all three of which were measured in "Local Base," as well as "Amount Local," "Book Value Base," "Base Market Value," and "Settle Price."

107. ERFC received from BNYM reports showing FX rates that used the terms "Base Cost" and "Currency Cost in Base."

108. The reports ACERS received from BNYM purported to set forth only the "Rate" for FX trades.

109. When presented with these reports, none of the Virginia Funds had any reason to conclude that every one of the approximately 73,000 FX rates contained on the reports were assigned at the end of the day, at the extremes of the range of the day, without any regard for actual cost. Indeed, based upon the terms BNYM used to represent FX prices, the Virginia Funds thought that the rates presented reflected the market at the time of the requested FX trade, or the price that BNYM actually paid or received.

4. Standing-Instruction FX Trade Example

110. The Relator offered the following example of an actual trade to illustrate the profit earned by BNYM on standing-instruction FX trades:

(a) On October 1, 2009, CMS indicated that BNYM's standing-instruction clients would be selling approximately $12,500,000 in exchange for Canadian dollars (CAD).

(b) The USD/CAD opened at 7:00 a.m. in New York at 1.0730 (*i.e.*, 1.0730 CAD to buy $1.00). The rates fluctuated throughout the day, hitting the eventual low of 1.0682 at 9:00 a.m. The eventual high, of 1.0847, occurred later that day, in the afternoon.

(c) The Pittsburgh Transaction Desk learned no later than 9:30 a.m. of these $12,500,000 in accumulated standing-instruction client requests that it would need to execute by the end of the day.

(d) The Pittsburgh Transaction Desk conducted an internal currency transfer of $12,500,000 worth of Canadian dollars with Pittsburgh-based FX trader, Pat O'Brien, at 1.0795.

(e) The rate BNYM reported and credited to its standing-instruction FX clients, however, was the very lowest rate of the day: 1.0682.

(f) Therefore, BNYM earned an undisclosed profit of US$130,847.61, based on the rate of 1.0682 reported to its custodial banking clients for the sale of $12,500,000 worth of Canadian dollars, when the Pittsburgh Transaction Desk actually conducted its internal currency transfer for US dollars at the much higher rate of 1.0795.

(g) BNYM earned this undisclosed income completely at the expense of its standing-instruction clients, including the Virginia Funds.

111. Indeed at least one of the Virginia Funds was involved in this particular transaction. On October 1, 2009 BNYM assigned to the Fairfax County Funds a sale of Canadian Dollars at the rate of *exactly* 1.0682.

5. BNYM's Accounting System Shows Enormous Income Generated by its Deceptive Standing-Instruction FX Trades

112. The Relator reports that six-figure income, as shown in the example above, was a routine consequence of standing-instruction trades at BNYM. In fact, the majority of the BNYM's FX income was derived from the execution of standing-instruction trades.

113. BNYM's profits from each completed trade were immediately tabulated by its Profit/Loss accounting system, the Wall Street System. The Transaction Desks in both New York and Pittsburgh maintained a running Profit/Loss report that could be generated at any time.

114. FX traders reviewed this document to keep track of their personal Profit/Loss as well as the Bank's Profit/Loss. In addition, monthly reports were also generated. Both the monthly and daily reports also showed year-to-date reporting.

115. These profits represented the difference between the false high (or low) price that BNYM assigned and reported to its standing-instruction FX trade clients, and the price for BNYM's internal accounting entry. The bank's internal accounting maintained a separate profit/loss line solely for standing-instruction internal currency transfers, called a "CMS offset" or "CMSOFF."

116. In 2008, for example, as tracked on BNYM's internal FX accounting system, known as "Charlie," BNYM's Pittsburgh office produced $417,331,504 in FX income. The portion of that income directly attributable to standing-instruction internal currency transfers was $298,055,320, or 71.4% of the total. For 2009, as of October 15, the standing-instruction FX

income accounted for $201,356,865 of a total of $263,623,344, or 76.4%.[9] As of August 28, 2009, the analogous numbers for the New York FX desk were approximately $130 million out of total income of $164 million, or 79.3%.

C. Internal BNYM Documents Show That Senior Management Was Aware of and Encouraged the Deceptive Scheme

117. Internal BNYM communications demonstrate that high-ranking members of Bank management were aware of the deceptive standing-instruction FX trading scheme, and of its importance to the profitability of the Bank. Indeed, these communications show high-ranking BNYM officers who were not only aware of the deceptive scheme, but who openly supported it, and its purpose to profit from the lack of knowledge of the Bank's customers.

118. As alleged in ¶¶ 12-15, on February 8, 2008, Jorge Rodriguez, BNYM's Executive Vice President of Global Sales and a Managing Director at the Bank's New York City offices, e-mailed the Bank's Executive Vice President of Global Markets, Richard Mahoney, and a number of other high-ranking New York City-based BNYM executives. In that e-mail, Mr. Rodriguez warned that BNYM would lose its "pricing advantages" if its custodial banking clients, including the Virginia Funds, no longer agreed to, and migrated away from, "standing-instruction" trading:

(a) Mr. Rodriguez explained to his fellow BNYM executives that "Standing instruction FX is ***the most profitable form of business***."

(b) Mr. Rodriguez further highlighted the bank's "free intra-day option

[9] Specifically, there was a Charlie report known as "CMS Internal Transaction Summary Report" that contained this information in summary form. These transactions were also recorded in the CMS Internal Transaction reports, which illustrated where each FX deal was done and how close BNYM's buys and sells were to the high and low of the daily FX ranges.

to ***time its currency execution*** in the marketplace knowing it ***does not have to get back to the customer immediately*** with the deal price."

(c) Custodial banking services "of this type," he continued, "also allow[] us to take advantage of increased market volatility and wide intra-day trading ranges. All these ***pricing advantages disappear when a client trades via an e-commerce platform and full transparency is achieved.***"

(d) Mr. Rodriguez concluded by noting that when these "ultra friendly" clients decide not to utilize BNYM's standing-instruction FX trading service, "margins greatly decline as the free intra-day option feature previously enjoyed disappears . . . and ***the client's ability to carefully monitor each and every trade at the time of execution reduces margins dramatically.***"

(Emphasis added.)

119. As this e-mail demonstrates, BNYM senior management knew, and approved of, FX traders' assignment of optimum prices to present to its clients, including the Virginia Funds, to inappropriately and deceptively maximize the Bank's own profits. Indeed, the email acknowledges that if custodial banking clients were presented accurate information (*i.e.*, "full transparency"), the Bank's profitability would suffer.

120. This internal awareness, and approval, continued well past October 2009, when the California Attorney General intervened in the *California v. State Street*. Specifically, as late as July 2010, BNYM management admitted in internal communications that the Bank was still not transparent in what it reported to its custodial banking clients regarding the actual pricing of FX trades. Additionally, these communications demonstrate management's belief that this lack of transparency was a leading cause of BNYM's profitability.

121. In fact, on July 21, 2010, Robert Near, Managing Director and head of North American FX Sales, emailed Mr. Rodriguez and others, informing them that in the months following the revelations of *California v. State Street*, BNYM "has been more successful in maintaining spreads in the [standing-instruction] space compared to these peers [State Street and Northern Trust]. Another way to say this is [BNYM] is 'late' to the transparency space. We are hearing from our clients that our competitors are offering time stamping and fixed spreads across all currencies."

D. BNYM Owed a High Standard of Care to the Virginia Funds

1. The Fairfax County Funds

122. BNYM acted as custodian to Fairfax County's retirement funds pursuant to two separate Custody Agreements.

123. In connection with negotiations leading to the final terms of the Custody Agreements, on November 16, 2001, Mellon Trust Vice President Richard A. Rollins sent a letter to Jeffrey A. Willison of the Fairfax County Retirement Systems which included a certification that "all services and systems described are available, deliverable and performed by professionals ***abiding to the highest fiduciary standards***."

124. The Fairfax County Employees' Retirement System, the Fairfax County Police Officers Retirement System, and the Fairfax County Uniformed Retirement System collectively entered into a formal, written "Custody Agreement" with Mellon Bank, N.A., dated May 1, 2002, pursuant to which Mellon Bank, N.A. would act as custodian to the Fairfax County Funds and provide certain custodian-related services thereunder.

2. ERFC

125. ERFC separately entered into a formal, written "Custody Agreement" with Mellon Bank, N.A., dated December 30, 2002, pursuant to which Mellon Bank, N.A. would act

as custodian to ERFC and provide certain custodian-related services thereunder. As part of the negotiation leading to entering into the Custody Agreement, Susan G. Testa, Vice President of Defendant stated in part, that "all services and systems described herein are available, deliverable and performed by professionals abiding to the highest fiduciary standards."

126. Among other things, the Custody Agreement provided, in part, that the Defendant would act as a "fiduciary" and, "[i]n performing its duties under this Agreement, the Custodian shall exercise the same care and diligence that it would devote to its own property in like circumstances."

3. ACERS

127. ACERS entered into a Global Custody Agreement with Bank of New York ("BNY"), dated April 1, 2002, pursuant to which BNY would act as custodian to the System and provide certain custodian-related services thereunder. The Global Custody Agreement provided that ACERS entrusted its property to the Custodian for its "custody and safekeeping" and set forth certain duties and responsibilities of the Custodian.

128. The April 1, 2002 Global Custody Agreement was silent as to a fiduciary duty. When ACERS entered into a new Custody Agreement with BNYM on June 29, 2010, however (pursuant to which BNYM would continue to act as custodian to ACERS and provide custodian-related services), the Bank expressly disclaimed any fiduciary duty. This disclaimer was inserted because prior thereto it was the intent of the parties that BNYM have the standard of care of a fiduciary.

4. VRS

129. VRS entered into a formal, written "Custodian Agreement" with Boston Safe Deposit and Trust Company ("Boston Safe") dated June 1, 1988, pursuant to which Boston Safe was to act as custodian to VRS, and perform certain custodian-related services thereunder.[10]

130. The Custodian Agreement provided, in part, that "Boston Safe shall discharge its duties under this Agreement with the care, skill, prudence and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims and responsibilities."

131. The "care, skill, prudence and diligence" of a custodial bank, paid millions of dollars in annual fees to maintain custody and control over billions of dollars of a public pension fund's assets (taxpayers' money) and in possession of highly confidential financial information of that public pension funds includes, among others, duties of honesty, loyalty, trust, and candor including, but not limited to, the duty to accurately and completely account for all income and expenses credited to and charged from the custodial property, without exception.

132. By its entry into side agreements with certain of the Virginia Funds' Outside IMs, BNYM attempted to change the nature of its relationships as set forth in the various contracts to one in which BNYM would be a "principal" dealing at arms length with each of the Virginia Funds. However, nothing in the various Custodian Agreements referred to above authorized or permitted BNYM to alter the scope of its duties to the Virginia Funds without the agreement of the particular funds.

133. The Virginia Funds did not learn until recently, after beginning to discuss the claims herein with BNYM, that BNYM had apparently entered into side agreements with some of the Virginia Funds' Outside IMs. These side agreements purported to change the nature of the

[10] In 2003, Mellon Bank acquired Boston Safe, which then became Mellon Trust of New England, N.A.

duties BNYM owed to the Virginia Funds and to permit BNYM to conduct standing-instruction FX trades pursuant to the procedures referred to in ¶¶ 6-7, 16-17, 76-78, 87, 102, 131.

5. BNYM Was a Fiduciary to the Virginia Funds by Virtue of Their Reasonable Reliance on BNYM's Expertise, Trust, and Loyalty

134. Each of the Virginia Funds reposed a high degree of trust in BNYM to execute standing-instruction FX transactions, and the Bank understood that to be the case. In conducting standing-instruction FX transactions on the Virginia Funds' behalf, BNYM occupied a superior position to the Funds due to the Bank's control over all aspects of the FX trades, including the timing of the trades, the price at which the trades were executed, access to the Virginia Funds' cash used to pay for purchases of currencies, and access to the Virginia Funds' accounts to which cash received for sales of currencies would be credited.

135. The Virginia Funds further depended upon BNYM not only to execute the trades, but also to accurately and honestly account with respect to each transaction conducted on their behalf.

136. Additionally, throughout the many years that it served as their custodian bank, BNYM relationship personnel consistently referred to the Bank as the Virginia Funds' "strategic partner." The Virginia Funds' personnel took this reference seriously, never imagining that its strategic partner was earning secret income at their expense.

137. BNYM's reference to itself as a "partner" and worthy of "trust" was intentional. Indeed, internal BNYM documents establish that the Bank knew its clients considered it to be a trusted expert, guarding their money with the utmost fidelity.

138. For example, BNYM's CEO Bob Kelly maintained a blog—named "Bob's Blog"—hosted on the Bank's internal intranet. In one of his blog posts during the autumn of 2009, Mr. Kelly emphasized "what our clients said we do really well: execute superbly and

honor the trust our clients place in us. We asked our client panelists to describe us in one word. The words we heard were '***trust***,' '***dedicated***,' and '***partner***.'" (emphasis added.)

E. BNYM's Custodian Banking Agreements With the Virginia Funds Contemplated and Promised No-Cost FX Trading

139. The Virginia Funds relied on BNYM's representations that standing-instruction FX trades were provided without cost beyond agreed upon fees and expenses.

1. The Fairfax County Funds

140. The Custody Agreement acknowledged that the Fairfax County Funds and the Custodian "desire to establish a custody account to provide for the safekeeping and recordkeeping of certain property of each Retirement System." Among the duties of the Custodian was to hold the property of the Fairfax County Funds for its safekeeping, to collect income earned by, and distributions due to the property, to collect all proceeds from securities, certificates of deposit or other investment which may mature or be called, to submit to the Fairfax County Funds information the Custodian received regarding ownership rights pertaining to the property held in the account, to attend to any involuntary corporate actions, and to render periodic statements with respect to the property held under the Custody Agreement.

141. Among the directed powers of the Custodian was to settle purchases and sales and engage in other transactions with respect to the securities in the account, to execute proxies for any of those securities, to lend the assets of the account in accordance with the terms of a separate lending agreement, to invest available cash in an interest bearing account, and to "[t]ake any and all actions necessary to settle transactions in futures and/or options contracts, short-selling programs, foreign exchange or foreign exchange contracts, swaps and other derivative investments . . ."

142. The Custody Agreement further provided that the compensation to which the custodian was entitled was that set forth in an RFP, and including a fee letter dated March 14, 2002, all of which were incorporated into the Custody Agreement by reference.

143. The March 14, 2002 fee letter provided that Mellon Bank, N.A. would be paid a flat fee of $465,000 per year for "all of the services that have been identified in our RFP response . . ."

144. In addition, Mellon Trust's response to the referred to RFP specifically stated that ***there will be no additional charge for FX trades executed by the Custodian.***

145. The following question was posed in the Request for Proposal and answered by Mellon Trust at page 178 of its response:

> **What is the fee for processing foreign currency trades executed internally or by a third party? Is there a penalty for any FX trades externally executed? Specify the costs in the *Business Proposal.***
>
> Mellon Trust does not charge for FX trades executed internally. External FX trades are charged at $50 per trade. This fee has been included in the *Business Proposal.*[11]

146. Standing-instruction FX transactions were not among the services for which BNYM was permitted to charge an additional fee or any other cost above the fees set forth in the contract.

147. The Custody Agreement was amended as of both May 1, 2005, and May 28, 2008 to change the amount of the yearly flat fee payable by the Systems to $490,000 and $400,000 respectively to compensate the Custodian for the same services set forth in the letter dated March 14, 2002 and the RFP.

---

[11] The *Business Proposal* set forth a flat, asset-based annual fee for services required.

2. ERFC

148. Among the duties of the Custodian was to hold the property of the ERFC in safekeeping, to collect income earned by, and distributions due to the property, to collect all proceeds from securities, certificates of deposit or other investment which may mature or be called, to submit to the ERFC information the Custodian received regarding ownership rights pertaining to the property held in the account, to attend to any involuntary corporate actions, and to keep accurate and detailed records and render periodic statements with respect to the property held under the Custody Agreement.

149. The Custody Agreement integrated by reference the provisions of BNYM's RFP response, which included among its "General Terms and Conditions" that "[n]o services for which an additional cost or fee will be charged by the offeror shall be furnished without the prior written authorization of the ERFC."

150. Under "Special Provisions, Business Proposal Instructions", the Request for Proposal specifically stated that:

> **NOTE**: Offerors shall prepare and submit proposals that are **all inclusive** of all costs related to the scope of service contained herein, except where otherwise noted.

(Bold and underline in original.)

151. The Custody Agreement was amended as of May 21, 2004 to extend the Agreement for an additional period of twenty months until June 30, 2007 with the option to extend for an additional two-year period subject to payment of consideration set forth in a letter from Todd Bailey to Alan Belstock, dated April 15, 2004. None of the documents set forth any additional amounts the Custodian was permitted to charge ERFC above the fees set forth therein for standing-instruction FX trades.

152. ERFC entered into a new Fee Schedule, effective July 1, 2008, for a three-year period, one that provided that the Custodian would be paid a flat fee of $200,000 per year and all other fees would be waived, including any transaction fees for FX not executed at BNYM Asset Servicing. None of the documents set forth any additional amounts the Custodian was permitted to charge ERFC any amounts in addition to the fees set forth in the Fee Schedule for standing-instruction FX trades.

3. ACERS

153. Among BNYM's duties and responsibilities under the Global Custody Agreement were to receive and deliver the property of ACERS, to settle the purchase and sale of securities transactions, and to render periodic accountings with respect to the property held under the Custodian Agreement.

154. The Global Custody Agreement provided that the compensation to which the custodian was entitled was "in accordance with and pursuant to the Fee Schedule annexed hereto as Schedule B . . ."

155. Schedule B provided that "[t]he following fees will apply from April 1, 2002 through December 31st, 2004." The Schedule provided at point I., for an all inclusive domestic and international asset based fee of 1.0 basis point per annum charge on total asset value. The Schedule further stated:

> ***There is no charge for Foreign Exchange transactions executed through The Bank of New York.*** A charge of $50.00 will be assessed for each foreign exchange executed through a third party.

(Emphasis added.)

156. ACERS entered into a new Global Securities Fee Schedule with BNY, dated July 26, 2005, providing for an increase to $70 for Foreign Exchange transactions undertaken through

a third party. It did not provide for any charge to ACERS for standing-instruction FX trades executed through the Custodian.

157. Pursuant to a letter dated October 27, 2005 from BNY to ACERS, BNY acknowledged that it granted ACERS a "most favored nation custody fee price for a comparative Public Fund" of 0.75 basis points on the total U.S. asset value per annum, and referenced international fees per "the attached schedule," none of which included a fee for standing-instruction FX traded through the Custodian.

158. Pursuant to a letter, dated March 25, 2010, from BNYM Asset Servicing to the System BNYM enclosed a new Fee Schedule, effective July 1, 2009 through June 30, 2011. The Fee Schedule provided for certain categories of fees based on both asset-based and transactional charges. The Fee Schedule did not provide for any charge to ACERS for standing-instruction FX trades executed through the Custodian.

159. The new Custody Agreement provided that the Fee Schedule in effect at the time of the execution of this Agreement was attached thereto as Exhibit F. The attached Fee Schedule set forth a charge only for FX *not* executed by BNYM and did not set forth any charge to ACERS for standing-instruction FX trades executed through the Custodian.

4. <u>VRS</u>

160. The Custodian Agreement provided that the compensation to which the custodian was entitled would be set forth in "a fee schedule agreed upon by the Client and Boston Safe. This fee schedule shall be provided in Exhibit A and in no other provision of this Agreement."

161. The Fee Schedule provided for a flat fee of $166,250 per quarter for "Domestic Custody" for up to 50 manager accounts, and for "Global Custody":

> 12 Basis Points annually on total non-pooled assets charged quarterly based upon quarter-end market value.

> 1 Basis Point annually on total pooled assets charged quarterly based upon quarter-end market value.
>
> $20 per non-pooled transaction plus $15 for each F/X contract not executed with a Hub manager.

162. The Fee Schedule did not list standing-instruction FX transactions among the services for which BNYM was permitted to charge an additional fee or any other cost above the fees set forth above.

163. The Fee Schedule further provided that "the fees stated herein are guaranteed for a period of three years from the commencement of the contract . . ."

164. By Addendum to the Custody Agreement, the parties entered into a new Fee Schedule effective July 1, 1991, for a period of three years that continued to provide for a flat fee for domestic custody, now provided a flat fee for global custody, and continued to provide a fee of $20 per non-pooled transaction plus $15 for each F/X contract not executed with Boston Safe. Standing-instruction FX transactions executed with BNYM were not listed among the services for which BNYM was permitted to charge an additional fee or any other cost above the fees set forth above.

165. The parties entered into new Fee Schedules approximately every three years thereafter including on July 1, 1994; July 1, 1997; June 26, 2001 (effective April 1, 2001); September 30, 2004; and July 1, 2007 (amended effective January 1, 2009), that provided for flat fees for domestic and global custody, but no longer included a charge for FX not executed with the custodian.

166. Significantly, each time the parties contemplated any change in fee or additional fee for a service for which the custodian was entitled to be paid, they did so in a written

agreement executed by the parties specifically describing the change or additional service, and the additional fee the custodian was entitled to charge.

167. There was no written agreement between the parties providing for standing-instruction FX transactions as a service for which BNYM was permitted to charge an additional fee or any other cost above the fees set forth in the contract. Thus, for over twenty-two years, VRS's Custodian Agreement with BNYM did not list standing-instruction FX transactions as one of the services for which BNYM was permitted to charge additional fees.

168. In June 2010, the parties again entered into a new Fee Schedule, effective July 1, 2010 through June 30, 2015. The July 1, 2010 Fee Schedule provided for an Annual Domestic Trust and Custody Flat Fee of $4.5 million per year for among other services, domestic and global structural charges, domestic and global administration charges, and domestic and global transaction charges.

F. BNYM Publicly Represented that Standing-Instruction FX Trading Was Free of Charge

169. As part of its deception, BNYM also marketed and represented through its website and other marketing materials the various foreign exchange services offered to its standing-instruction FX trade custodial clients[12]:

- "Standing Instruction [FX] trading provides a simple, flexible, and complete service solution that automates the capture of all types of custody-related foreign exchange . . . . Operationally simple, ***free of charge*** and integrated with the client's activity on the various securities markets, FX standing instruction [trading] is designed to help clients minimize risks and costs related to the foreign exchange and concentrate on their core business."

- "Standing Instruction Foreign Exchange Clients benefit from: execution according to ***best execution standards*** . . ."[13]

[12] These excerpts are all taken from BNYM's website as they appeared prior to the unsealing of the California v. State Street complaint.

[13] The duty of best execution requires that a custodian obtain for its client the most favorable terms reasonably available under the circumstances.

(Emphasis added.)

170. As described above, BNYM's representations had little or nothing to do with its actual practices. Nothing in these public representations came close to revealing the truth regarding BNYM's deceptive FX trading practices, whereby it assigned to its custodial banking clients, including the Virginia Funds, rates for standing-instruction trades that always, and without disclosure, maximized the Bank's income at those clients' expense. Moreover, after the *California v. State Street* case was announced, the language of the webpage was changed, so that no reference to "free of charge" standing-instruction FX trading remained.

G. BNYM's False Claims and Deceptive Acts and Practices Could Not Reasonably Have Been Detected by the Virginia Funds

1. BNYM Knowingly Deceived its Custodial Banking Clients About its Standing-Instruction FX Trading Practices

171. Standing-instruction FX trades involve the custodian, rather than the client or Outside IM, overseeing the trade process from start to completion. Clients have no input into the process and, absent a complete, honest, and candid accounting have no way of knowing how much income BNYM earns or what expenses it incurs.

172. Indeed, the Virginia Funds did not know, and had no reason to suspect, that BNYM was carrying on this deception. BNYM executed thousands of FX trades on behalf of the Virginia Funds every month. The reports the Virginia Funds received from BNYM showed only the rate that the Bank assigned for its FX trades. The reports did not include the price paid or received for foreign currency, the price charged or received in the internal transfer of currency, the range of the day, or the time of the day that a trade or internal currency transfer was executed.

173. Furthermore, it was reasonable for the Virginia Funds to presume that the accounting of transactions presented to them by BNYM was honest and reliable in accordance with the high duties and standards imposed upon it.

2. BNYM's Direct Communications With VRS Personnel Demonstrate a Willful Effort to Deceive its Clients

174. In late 2008, in the context of renegotiating the January 2009 Fee Schedule amendment, VRS communicated directly with BNYM to ascertain the specific sources of revenue the Bank was receiving from the pension fund. VRS asked Georgia Phillips, ASG First Vice President, to set forth all services from which BNYM was earning money from VRS.

175. In her response, Ms. Phillips identified a number of sources of revenue, including securities lending, cash management, and custodial fees. Despite the huge amount of income BNYM received as a consequence of VRS standing-instruction trades each year, Ms. Phillips did not include FX among these items.

176. A January 15, 2010 internal BNYM email confirmed VRS's request, as well as BNYM's incomplete and misleading response which had the effect of continuing the deception it had carried on for years. On that date, Ms. Phillips emailed Bruce Shain, BNYM's Managing Director of Asset Servicing, to update him on many of the ongoing communications between VRS and BNYM in the months following the revelations of *California v. State Street*. Among other topics, Ms. Phillips acknowledged not only that VRS previously requested all of BNYM's custodial services fee sources, but that the Bank did not include standing-instruction FX trading markups among those set forth in its response:

> [VRS personnel] are upset that when they asked us to share all sources of revenue, we did not include FX, especially in light of the fact that they [now] know that FX revenue is used to help offset our trust and custody fees. [T]hey would have preferred that we had full disclosure on fees. They would have accepted a higher custody fee if we did not factor in FX.

177. Direct communications between VRS personnel and BNYM officers and executives *after* October 20, 2009 also demonstrate that the bank had long engaged in a willful effort to conceal from its custodial banking client the deceptive FX rates it charged for standing-instruction FX trades.

178. These post-October 20, 2009 communications are best understood through the efforts of the members of the VRS investment team to contact BNYM within hours of learning about *California v. State Street* in order to inquire about its own custodian bank's FX practices. What followed were months of painstaking efforts by VRS to understand the true nature of BNYM's standing-instruction methods and to make sure that ongoing fee schedule amendments protected it from any further undisclosed mark-ups or fees in connection with VRS' standing-instruction FX trades.

179. For example, on October 21, 2009, shortly after learning of *California v. State Street* (but before the Qui Tam Complaint in this action was filed), Steve Henderson, VRS's Director of Fixed Income, asked Ms. Phillips, in essence, if BNYM was engaging in the same practices that were the subject of *California v. State Street* and, if so what was the nature of those practices. Ms. Phillips did not deny that BNYM marked up standing-instruction FX transactions, a fact that the Bank had never before disclosed.

180. On a subsequent phone call during the winter of 2009-10, Ms. Phillips' direct superior, Vincent Sands, acknowledged to Charles Grant, VRS's Chief Investment Officer and other personnel that he thought BNYM should have told VRS earlier about its revenues earned off of VRS's standing-instruction charges. When Mr. Grant asked why BNYM had never previously told VRS what it was charging the fund for its FX trading, Mr. Sands' only explanation was that revenue totals were so "variable" from year to year.

181. In another discussion during the same time period, Mr. Sands told Mr. Henderson and Larry Kicher, VRS's Chief Operating Officer, that with the benefit of hindsight, it would have been better had BNYM made VRS aware in or before January 2009 that standing-instruction FX charges were among the sources of revenue for BNYM in connection with its custodial banking services.

VII. BNYM' VIOLATED THE VIRGINIA FRAUD AGAINST TAXPAYERS ACT, VA. CODE ANN § 8.01-216.3(A)(1), (2), (4) AND (7)

182. The Commonwealth of Virginia repeats and realleges, as if fully set forth herein at length, each and every allegation contained in the above paragraphs.

183. BNYM had an obligation to render true and accurate records with respect to the property of the Commonwealth held by BNYM.

184. BNYM did render records with respect to the property of the Commonwealth held by BNYM.

185. BNYM, as part of its contractual duties as custodian of Commonwealth cash and other property, provided records and/or other reports to the Commonwealth in order to allow officers and agents of the Commonwealth to monitor the Virginia Funds' transactions, including FX transactions.

186. BNYM knowingly submitted these false and/or fraudulent claims regarding the standing-instruction FX costs in order to get the claims approved.

187. It was the knowing practice of BNYM to charge or credit, and then report, to the Commonwealth a higher or lower FX rate for every single standing-instruction trade BNYM executed as custodian for the Virginia Funds.

188. In the vast majority of cases of credits or debits arising as a result of standing-instruction FX transactions, BNYM debited more than the Commonwealth should have

paid for a standing-instruction FX purchase, and credited less than the Commonwealth should have received for a standing-instruction FX sale.

189. If the transaction was a "buy" of a foreign currency, BNYM would wait until the end of the FX trading day, at which time it would assign to the Commonwealth FX rates at or near the highest rate of the day (requiring the Commonwealth to purchase more currency than it otherwise would have had to purchase), in the process assigning and reporting to the Commonwealth a higher FX rate than (i) the rate that BNYM paid or received for the foreign currency, (ii) the FX rate at the time an instruction was given, or (iii) the FX rate at the time of BNYM's internal transfer of currency to or from its inventory to or from the Virginia Funds' accounts.

190. On the other hand, if the transaction was a sale of a foreign currency, BNYM would wait until the end of the FX trading day before falsely assigning and reporting to the Commonwealth FX rates at or near the lowest FX rate of the day (returning less currency to the Commonwealth than it otherwise would have received) rather than (i) the rate that BNYM paid or received for the foreign currency, (ii) the FX rate at the time an instruction was given, or (iii) the FX rate at the time of BNYM's internal transfer of currency to or from its inventory to or from the Virginia Funds' accounts.

191. BNYM would then keep for itself the difference between (i) the rate that BNYM paid or received for the foreign currency, (ii) the FX rate at the time an instruction was given, or (iii) the FX rate at the time of BNYM's internal transfer of currency to or from its inventory to or from the Virginia Funds' accounts and the fictitious or false assigned FX rate BNYM claimed to have paid on behalf of the Commonwealth.

192. As such, BNYM delivered, or caused to be delivered, less than all such money or property over which BNYM had possession, custody, or control.

193. BNYM also remitted to the cash accounts of the Commonwealth an amount less than (i) the rate that BNYM paid or received for the foreign currency, (ii) the FX rate at the time an instruction was given, or (iii) the FX rate at the time of BNYM's internal transfer of currency to or from its inventory to or from the Virginia Funds' accounts.

194. Therefore, based upon the foregoing, BNYM knowingly:

(a) presented false claims for the Commonwealth's approval;

(b) made, used, and presented to the Commonwealth false records and statements material to false claims;

(c) delivered to the Commonwealth less than the total amount of the Commonwealth's property and money used by the Commonwealth over which BNYM had possession, custody, and control;

(d) made, used, and presented to the Commonwealth false records and statements material to its obligation to pay and transmit money or property to the Commonwealth; and

(e) concealed and improperly avoided and decreased its obligations to pay and transmit money and property to the Commonwealth.

195. As a result of the knowing acts of BNYM, the Commonwealth has been damaged.

VIII. PRAYER FOR RELIEF

WHEREFORE, Plaintiffs demand:

(a) Pursuant to Va. Code Ann. § 8.01-216.3, BNYM shall pay at least $120,000,000, plus interest earned thereon, an amount equal to three times the Commonwealth's actual damages, estimated to be in excess of $40,000,000, based on the

Virginia Funds' standing-instruction FX trades, the rates of which BNYM falsely reported to the Commonwealth;

(b) Pursuant to Va. Code Ann. § 8.01-216.3, BNYM shall pay civil penalties of at least $811,624,000, based on a civil penalty of $11,000 for each of the 73,784 falsely reported standing-instruction FX trades conducted on behalf of the Virginia Funds;

(c) BNYM shall pay the Commonwealth's attorneys fees and litigation expenses; and

(d) BNYM shall pay for any such other relief as the Court may deem appropriate.

August 11, 2011

COMMONWEALTH OF VIRGINIA

By: _____
Of Counsel

Stephen E. Baril, Esq. (VSB# 19604)
Kelly B. LaPar, Esq. (VSB# 76041)
Sands Anderson PC
1111 East Main Street
P.O. Box 1998
Richmond, Virginia 23218-1998
Telephone: (804) 648-1636
Facsimile: (804) 783-7291
E-mail: sbaril@sandsanderson.com
klapar@sandsanderson.com

Jonathan J. Schraub, Esq. (VSB# 17366)
Brian Scotti, Esq. (VSB# 74510)
Sands Anderson PC
1497 Chain Bridge Road, Suite 202
McLean, Virginia 22101
Telephone: (703) 893-3600
Facsimile: (703) 893-8484
E-mail: jschraub@sandsanderson.com
bscotti@sandsanderson.com

Joel H. Bernstein, Esq.
Eric J. Belfi, Esq.
Ira A. Schochet, Esq.
David J. Goldsmith, Esq.
Paul J. Scarlato, Esq.
Michael H. Rogers, Esq.
Labaton Sucharow LLP
140 Broadway
New York, New York 10005
Telephone: (212) 907-0700
Facsimile: (212) 818-0477
E-mail: jbernstein@labaton.com
ebelfi@labaton.com
ischochet@labaton.com
dgoldsmith@labaton.com
pscarlato@labaton.com
mrogers@labaton.com

Kenneth T. Cuccinelli, II
Attorney General
Charles E. James, Jr.
Chief Deputy Attorney General
Wesley G. Russell, Jr.
Deputy Attorney General
Sydney E. Rab, Esq. (VSB# 15105)
Sr. Assistant Attorney General
Counsel for the Commonwealth of Virginia
Office of the Attorney General
900 East Main Street
Richmond, Virginia 23219
Telephone: (804) 786-1109
Facsimile: (804) 371-2087
E-mail: srab@oag.state.va.us