

**STATE OF WISCONSIN
DEPARTMENT OF FINANCIAL INSTITUTIONS
DIVISION OF SECURITIES**

In the matter of:)
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WACHOVIA SECURITIES, LLC;) **ADMINISTRATIVE CONSENT ORDER**
and)
)
WACHOVIA CAPITAL MARKETS,) **File No. S-09137(EX)**
LLC,)
Respondents.)
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_____)

WHEREAS, Wachovia Securities, LLC¹ (“Wachovia Securities”), is a broker-dealer registered in the state of Wisconsin with its home office at One North Jefferson Avenue, St. Louis, Missouri, and Wachovia Capital Markets, LLC (“Wachovia Capital Markets”, collectively with Wachovia Securities, “Wachovia”²), is a broker-dealer with its home office at 301 South College Street, Charlotte, North Carolina; and

WHEREAS, a multi-state task force conducted and coordinated investigations into Wachovia’s marketing and sale of auction rate securities to investors during the period of January 1, 2006, through February 14, 2008; and

WHEREAS, after a books and records inspection by a multi-state task force on July 17, 2008, Wachovia Securities has cooperated fully with regulators conducting the investigations by responding to inquiries, providing documentary evidence and other materials, and providing regulators with access to information relating to the investigations; and

WHEREAS, Wachovia has advised regulators of its agreement to resolve the investigations relating to its marketing and sale of auction rate securities to investors; and

¹ In October 2007, Wachovia Corporation acquired the Missouri-based broker dealer A. G. Edwards & Sons, Inc. (“AG Edwards”) which was subsequently combined with Wachovia Securities, LLC.
² Factual allegations in this Order may apply to Wachovia Securities and/or Wachovia Capital Markets, but do not necessarily refer to both entities.

1 of investor complaints concerning the sale of ARS by Wachovia Securities.

2 **Marketing and Sales of ARS to Investors**

3 4. In connection with the sale of ARS, some Wisconsin investors state variously that they
4 were told by Wachovia Securities and its registered agents that ARS were:

- 5 a. just like cash;
- 6 b. same as cash;
- 7 c. safe as cash;
- 8 d. same as money markets;
- 9 e. safe as money markets;
- 10 f. cash equivalents;
- 11 g. short-term adjustable rate securities;
- 12 h. cash alternatives;
- 13 i. completely safe;
- 14 j. liquid at any time; and/or
- 15 k. always liquid at an auction.

16 Although marketed and sold to investors as safe, liquid, cash-like investments, and although the ARS
17 market had, in fact, functioned for more than twenty years with virtually no auction failures, ARS are
18 actually long-term instruments subject to a complex auction process that, upon failure, can lead to
19 illiquidity and lower interest rates.

20 5. Wachovia Securities further fostered the misconception that ARS were cash-like
21 instruments by providing account portfolio summaries to certain of its customers that listed ARS as “cash
22 equivalents.” In fact, ARS were not “cash equivalents” and full liquidity was only available at an auction
23 if the auction was successful.

24 6. Although Wachovia Securities sold ARS as conservative, safe, and liquid investments to
25 its investors until February 2008, Wachovia had information that several auctions had failed in August

1 2007 and early 2008, before the mass failures in February 2008. During this same period of time,
2 Wachovia failed to inform its customers purchasing ARS after such auctions began to fail that certain
3 auctions would have failed had Wachovia or another broker-dealer not entered support bids in those
4 auctions.

5 7. Although Wachovia knew, or should have known, of the inherent risks and the recent
6 volatility of the ARS market, only minimal information regarding the ARS market was provided to
7 Wachovia Securities' retail ARS customers.

8 8. Wachovia and its registered securities agents were, or should have been, aware that the
9 ARS market was suffering from increasing failures and liquidity issues, and they should have disclosed
10 those facts to investors who were purchasing auction rates after such issues arose. Based on these facts,
11 Wachovia engaged in dishonest and unethical practices in the marketing and sale of ARS. Pursuant to the
12 Wisconsin licensing provision prohibiting dishonest or unethical practices under sec. 551.34(1)(g), Wis.
13 Stats., which was the statute applicable during the relevant time period with respect to this Consent Order,
14 such practices constitute grounds to revoke Wachovia's license/registration. These practices included,
15 among other things, the following:

16 a. Wachovia told some ARS investors purchasing ARS after the market disruptions
17 began to occur that:

- 18 i. ARS were cash equivalents;
- 19 ii. ARS were completely safe; and/or
- 20 iii. ARS were liquid at any time.

21 b. Wachovia was or should have been aware that the market for ARS was becoming
22 illiquid, yet Wachovia Securities continued to market and sell ARS to investors.

23 **Temporary Maximum Rate Waiver on Certain ARS**

24 9. The interest rates on ARS are reset periodically through the auction process. In the event
25 that there is insufficient demand for a particular issue and an auction fails, the interest rate resets to a

1 “maximum rate” or “failure rate” as defined in the offering documents for that particular issue. Typically,
2 this maximum rate would be higher than prevailing market rates in order to compensate ARS holders who
3 are unable to sell their positions and offer an “incentive” to induce buyers to return to the market although
4 in some cases, particularly for student loan auction rates, the maximum rate might be lower than the
5 prevailing rate.

6 10. In December 2007, with the encouragement of its underwriters, the Missouri Higher
7 Education Loan Authority (“MOHELA”) sought and secured approval to waive its maximum rate for
8 certain issues of ARS. Absent such waivers, the ARS issued by MOHELA would not have been allowed
9 to reset at interest rates high enough to clear auctions.

10 11. As a result of the maximum rate waivers, certain MOHELA ARS issues reset to a higher
11 rate for a brief period after the waiver was implemented. However, due to a feature of those issues that
12 caps the average interest rate over any given one-year period, the interest rates reset to 0% after the
13 expiration of the waiver period. The ramifications of this maximum rate waiver were not explained to
14 Wachovia Securities’ customers who subsequently purchased MOHELA ARS.

15 12. Wachovia Securities engaged in dishonest and unethical practices by not adequately
16 explaining to individual investors who purchased ARS with maximum rate waivers, among other things,
17 the following:

18 a. that the ARS interest rates could not be reset at a level that would prevent a failed
19 auction absent the maximum rate waiver; and

20 b. that the high interest rate allowed by the waiver would expire at the end of the
21 waiver period unless extended by the issuer.

22 Pursuant to the Wisconsin licensing provision prohibiting dishonest or unethical practices under sec.
23 551.34(1)(g), Wis. Stats., which was the statute applicable during the relevant time period with respect to
24 this Consent Order, such practices constitute grounds to revoke Wachovia’s license/registration.

25 **Failure To Supervise Agents Who Sold ARS**

