

**WRITTEN STATEMENT OF THE  
NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION**

U.S. House Committee on Financial Services

“Auction Rate Securities Market: A Review of Problems and Potential Resolutions”

September 18, 2008

**Introduction to NASAA**

The North American Securities Administrators Association (NASAA) is the oldest international organization devoted to investor protection. It was organized in 1919 and is a voluntary association with a membership consisting of 67 state, provincial and territorial securities regulators in the 50 states, the District of Columbia, Puerto Rico, the U.S. Virgin Islands, Canada, and Mexico.

State securities administrators are responsible for enforcing state securities laws, licensing of firms and investment professionals, registering certain securities offerings, examining broker-dealers and investment advisers, and providing investor education programs and materials. Eleven administrators are appointed by their Secretaries of State, others by their Governors, some are independent commissions, and five fall under the jurisdiction of their states’ Attorneys General.

State securities regulators respond to investors who typically call them first with complaints, or request information about securities firms or individuals. They work on the front lines, investigating potentially fraudulent activity and alerting the public to problems. Because they are closest to the investing public, state securities regulators are often first to identify new investment scams and to bring enforcement actions to halt and remedy a wide variety of investment related violations.

**Auction Rate Securities Investigations**

State securities regulators began responding to auction rate securities (ARS) related complaints soon after the auction rate securities market froze in February 2008. State offices received complaints from a wide range of outraged investors – young families saving for a first home, small business owners, retirees, and people with parents in nursing homes – whose financial lives have literally been put on hold because the money they were told was “cash-like” was tied up in the frozen market and inaccessible to them. NASAA members have logged hundreds of complaints from individuals holding frozen auction rate securities valued at hundreds of millions of dollars.

Given the growing number and the serious nature of the complaints received around the country, state securities regulators initiated a collaborative approach to investigate the

marketing and sale of auction rate securities by various broker-dealers. On April 13, 2008, NASAA announced the formation of its Auction Rate Task Force, chaired by Bryan Lantagne, Director of the Massachusetts Securities Division. The original Task Force members included state securities regulators from Florida, Georgia, Illinois, Massachusetts, Missouri, New Hampshire, New Jersey, Texas, Virginia and Washington. These states led the national effort and continue to serve, with California and Pennsylvania, as leads in the investigative process. There are many other states functioning in supporting capacities.

From its inception, the goal of the task force members has been to restore liquidity to ARS investors and, as of today, the firms have agreed to buy back an estimated more than \$50 billion of the securities from investors. When all is said and done, this will be the single largest repayment to investors in the history of the capital markets.

The investigations covered the breadth of the problem from underwriting, to the auction process, to marketing, sales practices and the conflicts of interest that arose between the firms and their customers.

#### **Enforcement Actions**

On June 26, 2008, the Massachusetts Securities Division of the Secretary of the Commonwealth filed the first ARS related enforcement action, which was against UBS Financial Services (UBS). The case highlights the profound, undisclosed conflict of interest that arose between UBS and its customers: The firm was promoting ARS securities to its clients at the same time that it was desperate to reduce its own inventory, based on concerns about potential problems in the ARS auction market. The complaint also describes the pattern of deceptive sales practices that UBS agents used to sell ARS securities to unsuspecting clients.

The Massachusetts Securities Division followed the UBS complaint with one against Merrill Lynch, Pierce, Fenner & Smith (Merrill Lynch) on July 31, 2008. This administrative complaint addresses the manner in which Merrill Lynch conducted its ARS business, as well as how it interacted with its research department. It charges the firm with separate counts of fraud and dishonest and unethical conduct for creating and implementing a sales and marketing scheme that significantly misstated not only the nature of auction rate securities, but also the overall stability of the auction market, resulting in thousands of investors being abandoned with illiquid investments.

#### **Settlements in Principle**

As of September 16, nine Wall Street firms have reached settlements in principle to restore an estimated more than \$50 billion of liquidity to over 183,000 investors across the nation.

Members of the NASAA Task Force, working in conjunction with the New York Attorney General and the Securities and Exchange Commission (SEC), have negotiated

settlements in principle with Citigroup, Credit Suisse, Deutsche Bank, Goldman Sachs, JP Morgan, Merrill Lynch, Morgan Stanley, UBS, and Wachovia. Settlement negotiations are ongoing with several additional firms. The terms of the settlements are not identical because there were different and varying degrees of alleged wrongdoing uncovered at each firm. In addition to restoring liquidity to investors, the common elements of the settlements in principle include:

- establishing a dedicated telephone assistance line, with appropriate staff, to respond to questions from customers concerning the terms of the settlement;
- establishing of a special arbitration procedure for the exclusive purpose of arbitrating any relevant class member's consequential damages claim;
- refunding of refinancing fees to municipal auction rate issuers that issued such securities in the initial primary market between August 1, 2007 and February 11, 2008, and who refinanced those securities after February 11, 2008; and
- assessing fines and penalties payable to the States reflecting the firms' dishonest and unethical marketing and sale of auction rate securities to investors.

A synopsis of each firm's settlement in principle follows:

**Citigroup.** The Texas State Securities Board led the investigation into allegations that Citigroup misled its clients by falsely assuring them that ARS were as safe and liquid as cash. On August 7, 2008, NASAA President Karen Tyler, Texas Securities Commissioner Denise Voigt Crawford, New York Attorney General Andrew Cuomo, and the Securities and Exchange Commission announced that a settlement in principle had been reached with Citigroup, Inc., to give thousands of Citigroup clients' access to billions of dollars in funds that have been frozen in the ARS market.

Under the terms of the settlement announced by state and federal regulators, Citigroup will offer to repurchase at par, no later than November 5, 2008, all auction rate securities from all Citigroup retail customers who held those securities at the time the auction market failed on February 12, 2008. For purposes of the settlement, retail customers are defined to include individual investors, all businesses with account values of up to \$10 million, and all charities regardless of account values.

**UBS.** On August 11, 2008, NASAA President Karen Tyler announced that a settlement in principle had been reached between UBS Securities LLC and UBS Financial Services, Inc. (UBS) and state and federal securities regulators. Massachusetts, New York and Texas all had leading roles in investigating UBS's misconduct and in negotiating the settlement.

Under the terms of the settlement, UBS will buy back, no later than October 31, 2008, all illiquid auction rate securities from all UBS retail customers, including charities, who have less than \$1 million on deposit. In addition, no later than January 2, 2009, UBS will buy back all illiquid auction rate securities from all other UBS retail customers, charities, and small to mid-sized businesses. These customers, who number approximately 40,000 nationwide, have been unable to sell their securities since February 13, 2008.

**JP Morgan/Morgan Stanley.** The Illinois Securities Department, the Florida Office of Financial Regulation, the New York Office of the Attorney General, and NASAA announced, on August 14, that settlements in principle had been reached with JP Morgan and its affiliates (including Bear Stearns & Co. Inc.) and Morgan Stanley. The settlements concluded an investigation led by the Illinois Securities Department and the Florida Office of Financial Regulation into allegations that both firms misled clients by falsely assuring them that auction rate securities were as safe and liquid as cash.

Under terms of the settlement, Morgan Stanley has agreed to provide immediate liquidity to its retail investors who purchased auction rate securities through Morgan Stanley before February 13, 2008, and who are unable to sell those securities because of failed auctions, by offering to buy back the securities at par. The category of retail investors includes all individual investors, all charities and non-profits, and all institutional clients with account values and household values up to \$10 million. Morgan Stanley has made the offer effective immediately, and will complete all repurchases from investors who accept this offer by December 11, 2008.

Under the terms of the settlement, JP Morgan and its affiliates, including Bear Stearns & Co., Inc., will offer to repurchase, no later than November 12, 2008, all illiquid auction rate securities from all JP Morgan individual investors, charities, not-for-profit companies and institutional clients who have account values and household assets of up to \$10 million.

**Wachovia.** A settlement in principle was reached between Wachovia Securities and state and federal securities regulators on August 15, 2008. Under the terms of the agreement, Wachovia will repurchase illiquid ARS securities from all non-profit charities, as well as all individuals and businesses with account or household values up to \$10 million, no later than November 28, 2008. All other investors will be able to redeem their auction rate securities no later than June 30, 2009.

**Merrill Lynch, Goldman Sachs, Deutsche Bank.** On August 21, state securities regulators announced settlements in principle had been reached between Merrill Lynch & Co. Inc., Goldman Sachs Group Inc., and Deutsche Bank Securities Inc, Deutsche Bank AG. Under the terms of the settlement, Merrill Lynch agreed to buy back by October 1, 2008 all auction rate securities purchased through the firm by retail investors with accounts of \$4 million or less in assets. For all other retail investors and all other investors with accounts of \$100 million or less in assets, the buyback will occur by January 2, 2009.

Goldman Sachs agreed by November 12, 2008 to buy back auction rate securities for all retail investors who purchased auction rate securities through the firm and Deutsche Bank agreed to buy back auction rate securities from all retail investors who purchased auction rate securities through Deutsche by November 21.

**Credit Suisse.** On September 16, 2008, NASAA announced that a settlement in principle was reached between Credit Suisse Securities (USA) LLC and state securities

regulators, which concludes an investigation led by the Securities Division of the North Carolina Department of the Secretary of State, into allegations that the firm misled clients by falsely assuring them that auction rate securities were as safe and liquid as cash.

Under the terms of the settlement, Credit Suisse agreed to buy back at par value by December 11, 2008 all auction rate securities purchased through the firm by individual investors before February 14, 2008. Under terms of the settlement, "individual investors" include all individuals, legal entities forming an investment vehicle for family members, charities and non-profits, and small- to medium-sized businesses with account values of up to \$10 million with Credit Suisse.

### **Conclusion**

The auction rate securities investigations and settlements are examples of well-coordinated, collaborative efforts amongst state and federal regulators. They come only a few years after many of the same Wall Street firms were involved in the analysts' conflict of interest global settlement with the states, SEC, NYSE and the NASD (now FINRA). These examples of widespread misconduct in the financial services industry prove that now is the time to strengthen, not weaken our unique complementary regulatory system of state, federal and industry regulation. One hundred million investors – many of them wary and cynical -- expect regulators to remain vigilant – and to make sure that Wall Street puts investors first.