

BEFORE THE SECURITIES COMMISSIONER
OF THE STATE OF DELAWARE

SECURITIES
COMMISSION

09-2-2 11:09:11

DELAWARE

In the matter of:)
)
WACHOVIA SECURITIES, LLC;) Case No. 09-2-2
and)
)
WACHOVIA CAPITAL MARKETS,)
LLC,)
)
Serve Wachovia Securities, LLC at:) **ADMINISTRATIVE CONSENT ORDER**
)
One North Jefferson Avenue)
St. Louis, Missouri 63103)
)
Serve Wachovia Capital Markets, LLC)
at:)
)
301 S. College Street)
TW-8, Mail Code NC0602)
Charlotte, North Carolina 28288-0601)
)
Respondents.)

WHEREAS, Wachovia Securities, LLC¹ ("Wachovia Securities"), is a broker-dealer registered in the state of Delaware 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,

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 Wachovia Securities has cooperated fully with regulators conducting the investigations by responding to
2 inquiries, providing documentary evidence and other materials, and providing regulators with access to
3 information relating to the investigations; and

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

6 WHEREAS, Wachovia agrees to, among other things, reimburse certain purchasers of auction
7 rate securities, and to make certain payments at the direction of the Securities Commissioner for the State
8 of Delaware ("Commissioner"); and

9 WHEREAS, Wachovia elects to permanently waive any right to a hearing and appeal under the
10 provisions of the Delaware Securities Act (6 Del. C. Ch. 73) ("the Act") with respect to this Consent Order
11 (the "Order");

12 NOW, THEREFORE, the Commissioner, as administrator of the Act hereby enters this Order.

13 **I.**

14 **FINDINGS OF FACT**

15 1. Wachovia Securities admits the jurisdiction of the Commissioner and Wachovia Capital
16 Markets consents to the jurisdiction of the Commissioner for purposes of this Order. Neither admits nor
17 denies the Findings of Fact and Conclusions of Law contained in this Order, and each consents to the
18 entry of this Order by the Commissioner.

19 2. Auction rate securities are long-term debt or equity instruments that include auction
20 preferred shares of closed-end funds, municipal auction rate bonds, and various asset-backed auction rate
21 bonds (collectively referred to herein as "ARS"). While ARS are all long-term instruments, one
22 significant feature of ARS (which historically provided the potential for short-term liquidity) is the
23 interest/dividend reset through auctions that occur in varying increments of between 7 and 42 days. If an
24 auction is successful, investors are able to exit the ARS market on a short-term basis. If, however, an
25 auction "fails," investors are required to hold all or some of their ARS until the next successful auction in

1 order to liquidate their funds. Beginning in February 2008, the ARS market experienced widespread
2 failed auctions.

3 3. In early March 2008, Wachovia Securities' investors, unable to access their ARS funds,
4 began to submit complaints to various state securities regulators.

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

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

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

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

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

1 if the auction was successful.

2 6. Although Wachovia Securities sold ARS as conservative, safe, and liquid investments to
3 its investors until February 2008, Wachovia had information that several auctions had failed in August
4 2007 and early 2008, before the mass failures in February 2008. During this same period of time,
5 Wachovia failed to inform its customers purchasing ARS after such auctions began to fail that certain
6 auctions would have failed had Wachovia or another broker-dealer not entered support bids in those
7 auctions.

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

11 8. Wachovia and its registered securities agents were, or should have been, aware that the
12 ARS market was suffering from increasing failures and liquidity issues, and they should have disclosed
13 those facts to investors who were purchasing auction rates after such issues arose. Based on these facts,
14 Wachovia engaged in dishonest and unethical practices in the marketing and sale of ARS. Pursuant to
15 6 *Del. C.* § 7316(a)(7), these practices constitute grounds to revoke Wachovia's registration. These
16 practices included, among other things, the following:

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

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

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

Temporary Maximum Rate Waiver on Certain ARS

1
2 9. The interest rates on ARS are reset periodically through the auction process. In the event
3 that there is insufficient demand for a particular issue and an auction fails, the interest rate resets to a
4 “maximum rate” or “failure rate” as defined in the offering documents for that particular issue. Typically,
5 this maximum rate would be higher than prevailing market rates in order to compensate ARS holders who
6 are unable to sell their positions and offer an “incentive” to induce buyers to return to the market although
7 in some cases, particularly for student loan auction rates, the maximum rate might be lower than the
8 prevailing rate.

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

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

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

- 21 a. that the ARS interest rates could not be reset at a level that would prevent a failed
22 auction absent the maximum rate waiver; and
- 23 b. that the high interest rate allowed by the waiver would expire at the end of the
24 waiver period unless extended by the issuer.

25 Pursuant to 6 Del. C. § 7316(a)(7), these practices constitute grounds to revoke Wachovia Securities’

1 registration.

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

3 13. Although ARS are complicated and complex products, Wachovia Securities did not
4 provide its sales or marketing staff with the training and information necessary to adequately explain
5 these products or the mechanics of the auction process to their customers. During the course of
6 investigations, on-the-record statements taken from Wachovia Securities' registered agents demonstrated
7 that these agents lacked a basic understanding of the functionality of the ARS products and the auction
8 rate market.

9 14. Many of Wachovia Securities' registered agents were not adequately educated in the
10 ARS products they were selling and did not know where to look for information to bolster that
11 knowledge. Wachovia Securities failed to provide timely and comprehensive sales and marketing
12 literature regarding ARS and the mechanics of the auction process. In addition, Wachovia Securities
13 failed to review account portfolio statements sent to its customers to ensure that they reflected accurate
14 information regarding ARS.

15 15. Wachovia Securities' failure to provide sufficient training and information concerning
16 ARS and the market environment in which they were sold was not limited to one or two agents, and is
17 therefore indicative of Wachovia Securities' failure to ensure that its registered personnel provided
18 adequate information regarding ARS to its customers.

19 16. Wachovia Securities failed to reasonably supervise its employees, which is grounds for
20 revocation of its registration under 6 Del. C. § 7316(a)(10):

- 21 a. failing to provide adequate training to its registered agents regarding ARS
22 by, among other things:
- 23 i. failing to provide timely and comprehensive sales and marketing
24 literature regarding ARS and the mechanics of the auction process;
 - 25 ii. failing to provide pertinent information concerning the complexity of the

1 ARS product; and

2 iii. failing to ensure that its agents were selling ARS to individual investors
3 for whom they were suitable; and

4 b. failing to review account portfolio statements sent to its customers to ensure
5 that they reflected accurate information regarding ARS;

6 c. failing to review ARS transactions in accounts of customers who needed
7 liquidity; and

8 d. failing to ensure that its registered personnel were providing adequate
9 information regarding ARS to its customers.

10 **II.**

11 **CONCLUSIONS OF LAW**

12 17. The Commissioner has jurisdiction over this matter pursuant to 6 *Del. C.* § 7325.

13 18. The Commissioner finds Wachovia Securities failed to supervise its employees and
14 engaged in dishonest or unethical practices in the securities business, and that this conduct constitutes
15 grounds to revoke Wachovia Securities' registration under 6 *Del. C.* §§ 7316(a)(7) and (10).

16 19. The Commissioner finds this order and the following relief appropriate, in the public
17 interest, and consistent with the purposes intended by the Act.

18 **III.**

19 **ORDER**

20 On the basis of the Findings of Fact, Conclusions of Law, and Wachovia's consent to the entry of
21 this Order,

22 **IT IS HEREBY ORDERED:**

23 1. This Order concludes the investigation by the Commissioner and any other action that the
24 Commissioner could commence under applicable Delaware law on behalf of Delaware as it relates to
25 Wachovia, and its marketing and sale of auction rate securities to investors.

1 9. As part of Wachovia's general obligation to notify all investors in the Relevant Class
2 pursuant to paragraph 8, above, Wachovia shall mail the Required Notification, defined below, by
3 November 10, 2008, to all investors in the Relevant Class that held ARS positions in a Wachovia account
4 as of August 31, 2008. For purposes of the Order, "Required Notification" shall mean a notice that
5 includes general statements and information specific to each investor, including:

- 6 a. a general notification of all provisions of this Order;
- 7 b. the specific security purchased;
- 8 c. the quantity purchased;
- 9 d. the par value of the holding;
- 10 e. a prominent statement disclosing that at this time the Relevant Class member's ARS
11 holdings may not be liquid and that there is a possibility that this offer may be the only opportunity
12 for the investor to liquidate the ARS holdings; and
- 13 f. a statement that the offer to repurchase the ARS holdings, and other relief specified
14 in the Order, is being made pursuant to a settlement with state securities regulators.

15 10. By November 10, 2008, Wachovia shall mail the Required Notification to all investors in
16 the Relevant Class that transferred ARS positions to a firm other than Wachovia, prior to the date of this
17 Order, if the initial purchase of the Eligible ARS was on or after January 1, 2003 unless the ARS has been
18 redeemed in full by the issuer.

19 11. Wachovia shall demonstrate that all investors in the Relevant Class received the Required
20 Notification if Wachovia demonstrates that: 1) Wachovia mailed the Required Notification via First
21 Class mail at the customer's last known address and did not receive a return notice, or 2) Wachovia
22 repurchased ARS from the investor.

23 12. Wachovia Securities shall establish and maintain a dedicated telephone assistance line,
24 with appropriate staff, to respond to questions from investors concerning the terms of this Order and
25 Wachovia's no net cost loan (nonrecourse, no release) program. Wachovia Securities shall maintain this
26

1 dedicated telephone assistance line through June 30, 2009.

2 13. With respect to any claim for consequential damages, to the extent such claims are not
3 resolved informally by Wachovia, Wachovia shall arbitrate the claim of any Relevant Class member who
4 elects to arbitrate, pursuant to the following provisions:

5 a. the arbitrations will be conducted by a public arbitrator (as defined by section
6 12100(u) of the NASD Code of Arbitration Procedures for Customer Disputes, eff. April 16,
7 2007), under the auspices of FINRA;

8 b. the above-referenced public arbitrator will be available for the exclusive purpose
9 of arbitrating any Relevant Class member's consequential damages claim;

10 c. Wachovia shall pay all applicable forum and filing fees;

11 d. any Relevant Class member who chooses to pursue such a claim shall bear the
12 burden of proving that they suffered consequential damages and that such damages were caused
13 by investors' inability to access funds consisting of investors' ARS purchases through Wachovia;
14 and

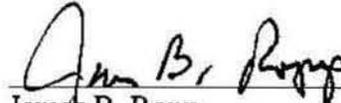
15 e. Wachovia shall be able to defend itself against such claims; provided, however,
16 that Wachovia shall not contest liability related to the sale of ARS; and provided further that
17 Wachovia shall not be able to use as part of its defense an investor's decision not to borrow
18 money from Wachovia.

19 14. By November 28, 2008, Wachovia Securities and Wachovia Capital Markets,
20 respectively and separately, shall refund refinancing fees received by it to municipal auction rate issuers
21 that issued such securities in the initial primary market between August 1, 2007 and February 13, 2008,
22 and refinanced those securities through Wachovia after February 13, 2008.

23 15. If Wachovia defaults in any of its obligations set forth in this Order, the Commissioner
24 may vacate this Order, at its sole discretion, upon 10 days notice to Wachovia and without opportunity for
25 administrative hearing or may refer this matter for enforcement as provided in the Act.

21. Wachovia shall pay its own costs and attorneys' fees with respect to this matter.

SO ORDERED this 31st day of March, 2009.


James B. Ropp
Securities Commissioner

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