



## ARS NEWSLETTER

April 4, 2008

### **REGULATORS BEGIN INQUIRY OF A.R.S. SALES PRACTICES; INVESTORS ENCOURAGED TO SUE BROKERAGE FIRMS**

Securities regulators have begun to launch inquiries into the sales practices employed by major brokerage firms in connection with the sale of auction rate securities. Massachusetts' top securities regulator said on Friday that his office was demanding information from three large investment houses as he deepens a probe into the \$330 billion auction-rate securities market. William Galvin issued subpoenas to UBS Securities, Merrill Lynch and Bank of America Investment Services to determine whether they told investors about the potential risks of these investments. As reported, Mr. Galvin stated that "the inquiry is seeking to determine whether investors were properly informed of the risks that their investments might become illiquid."

The Financial Industry Regulatory Authority ("FINRA"), which is the entity responsible for regulating broker/dealer compliance with industry rules, has also made critical statements regarding certain sales practices. In an Investor Alert,<sup>1</sup> FINRA states that "investors who purchase ARS are typically seeking a cash-like investment that pays a higher yield than money market mutual funds or certificates of deposit." This confirms, despite objections by firms, that investors believed they were getting liquid instruments, not 20 to 30 year obligations or even "no maturity" preferred shares. "If you need your money in a hurry, loss of liquidity is a financial hardship," states John Gannon, FINRA's Senior Vice President for Investor Education. "We want investors who have been affected by the recent auction failures to know what options are available to them."

Investors are now being encouraged to sue the brokers and/or brokerage firms that sold them the problematic investments. In an excellent article published in the New York Times,<sup>2</sup> Gretchen Morgenson outlines two choices that aggrieved investors may consider: 1) They can hope that the issuer of the auction-rate security will buy it back, or 2) sue the brokers who sold the securities, in many cases making verbal promises that they could be cashed in weekly. In Ms. Morgenson's article, she describes the plight of one investor who was sold auction-rate preferred shares in a closed-end fund. When the investor complained to the company, she was told to "go sue the person who sold you the product," and that "they have a responsibility to their common shareholders."

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<http://www.finra.org/InvestorInformation/InvestorAlerts/TradingSecurities/AuctionRateSecuritiesWhatHappensWhenAuctionsFail/P038207>

<sup>2</sup> <http://www.nytimes.com/2008/03/30/business/30gret.html>

It is becoming clearer that investors in auction-rate securities almost certainly relied on their brokers' assurances that the securities were safe and sound. Further, brokers who sold these products may have been misled by their employers about the nature of the products they were selling. An industry publication called *Registered Rep Magazine* reported<sup>3</sup> that one UBS broker, when asked if he ever told his clients that they could lose money in the reset market, stated, "**No. Never. No.** That's how the product was explained to us. It's as good as a money market." He also said access to the auction market "was a great prospecting tool" when meeting with wealthy potential clients. "Nobody ever thought these could lose money," he said. Another Smith Barney broker stated, "We were never, ever—ever, ever—told that these things could fail."

**Our firm is doing everything we can to help investors recover their money currently tied up in auction rate securities.** We will waive all legal fees if the issuer gives you your money back as a result of a demand letter. In addition, in the event the ARS market reverses itself, and you are able to sell your securities at par, we will also waive all legal fees.

Shepherd, Smith & Edwards, LLP is a law firm that handles securities cases for individuals and institutions nationwide. Our attorneys and staff have more than 100 years of brokerage and legal experience, placing us in a unique position of understanding both the law and the industry surrounding securities. If you have any questions, please contact us at (800) 259-9010 or email us at [arsinfo@sselaw.com](mailto:arsinfo@sselaw.com).

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<sup>3</sup> [http://registeredrep.com/regulatory/trouble\\_in\\_securities\\_land\\_03\\_28\\_2008/](http://registeredrep.com/regulatory/trouble_in_securities_land_03_28_2008/)