



## ARS NEWSLETTER

May 5, 2008

### **Brokerage Firms Continue to Profit During Auction Rate Securities Market Freeze**

It has been almost three months since the market for auction rate securities ground to an abrupt halt, yet little has changed to help provide investors with much-needed liquidity. Despite public outrage and calls for investigations by securities regulators in well over a dozen states, the brokerage firms that sold ARS to investors are taking little action to help their customers regain access to their cash. Unfortunately, under the current auction system, these brokerage firms have little incentive to alter the status quo.

The current auction process is loaded with conflicts of interest that may benefit a brokerage firm at the expense of either the investor or issuer. Although the ARS market is at a stand still, and investors and issuers alike are facing significant financial crises, the brokerage firms that run the auctions continue to make money. These firms charge an annual fee (0.25% of the security's total issue) to the issuer for bringing the ARS to auction. These fees are required to be paid regardless of whether the ARS find a buyer at auction (it is estimated that about 70% of weekly auctions are currently failing). These firms are cashing in on the plight of municipal issuers, who are facing mounting pressure from taxpayers to redeem ARS that have reset at high penalty rates. As these municipalities buy back their outstanding ARS, the firms are capturing substantial revenue in the form of banking fees.

While there has been some effort by closed-end funds to redeem certain auction rate preferred shares (ARPS), the vast majority of investors remain unaffected. The prevailing penalty rate for most of these ARPS is so low – around 3.5% – that issuers have little incentive to redeem. A small secondary market for ARS has developed, but requires investors to sell their securities at a discount. **Currently, municipal bond-based ARS are selling at discounts of 2% to 10%; ARPS at a 15% discount and student loan-based securities sell at discounts of 25% or more.**<sup>1</sup> Investors who are forced to sell at a discount may have a claim for damages against the firm and broker who initially recommended the investment.

**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 during the course of our representation of you. 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. If you have not already, please review the following:

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<sup>1</sup> GRETCHEN MORGENSON, *How to Clear a Road to Redemption*, N.Y. TIMES (May 4, 2008), available at <http://www.nytimes.com/2008/05/04/business/04gret.html>.

[http://www.stockbrokerfraudblog.com/2008/02/how\\_wall\\_street\\_firms\\_convince.html](http://www.stockbrokerfraudblog.com/2008/02/how_wall_street_firms_convince.html)

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).

**Message from Kirk Smith and Sam Edwards:** *We have spoken at length with many of our newsletter subscribers over the past two months. We are happy to devote our time to fielding questions, providing insight and sometimes, just being a sympathetic ear for the venting of frustrations. We know this is a trying time for all ARS investors, and we are happy to continue our discourse with you. Feel free to give us a call if we can be of any service.*

*Thanks,*

*Kirk and Sam*