

## ARS NEWSLETTER

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***In case you missed it, below is a copy of Gretchen Morgenson's recent article on Auction Rate Securities. The article details some of the redemption problems auction rate securities investors are experiencing. It seems, a large number of investors have fallen through the cracks of the national settlements with major brokerage firms.***

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Fair Game

The Investors Who Can't Come in From the Cold

By [GRETCHEN MORGENSON](#)

LIFE is unfair, as the saying goes, but for investors still stuck in auction-rate securities, the inequities keep on coming.

Auction-rate securities, you may recall, are preferred shares or debt instruments with rates that reset regularly, usually every week, in auctions overseen by the brokerage firms that originally sold them. They have long-term maturities or, in the case of the preferred shares, no maturity dates at all. The securities are issued by municipalities, student-loan companies, closed-end funds and tax-exempt institutions like hospitals and museums.

Brokers that peddled these securities told buyers that they were cash equivalents, easy to get out of and relatively safe. But the promises of liquidity turned false last February when buyers for the securities disappeared and the auctions began failing. The \$300 billion market for auction-rates ground to a halt, entrapping thousands of investors both large and small, sophisticated and novice.

Officials in Massachusetts, New York and other states came to the rescue earlier this year, striking settlements with some of the bigger brokerage firms in the arena.

But while some of the larger firms agreed to redeem the securities, not everyone is covered by those agreements. A group of people, size unknown, has fallen through the cracks in the settlements, and for several quirky reasons. They remain frozen in the securities and understandably upset.

Irene Scharf, a professor of [immigration](#) law at the Southern New England School of Law, in

North Dartmouth, Mass., is one of them. Back in 2005, she invested \$75,000 in several auction-rate securities backed by municipalities. The money was earmarked to pay college tuition bills for her two sons.

Ms. Scharf says she bought the auction-rate securities at the suggestion of her UBS broker. When that broker joined Smith Barney last year, she moved her account with him to the new firm. Unfortunately, that sequence of events disqualifies her from participating in the redemption of her securities as dictated by the various state settlements.

The terms of the Massachusetts settlement with UBS, for example, require it to redeem auction-rate securities of only those clients who bought them from the firm between Oct. 1, 2007, and Feb. 13, 2008, and who still hold them at UBS. The settlement covers \$19 billion in securities; UBS neither admitted nor denied wrongdoing.

The agreement struck by Smith Barney states that it will redeem auction-rate securities that were bought by its customers directly from the firm before Feb. 11, 2008. The deal, in which the firm neither admits nor denies wrongdoing, covers \$7.3 billion of securities. That leaves Ms. Scharf, however, out in the cold. Making matters worse, the college bills that her securities were supposed to cover are coming due.

“We lived very frugally for years so I would not have to take out loans when my kids went to college,” Ms. Scharf said. “I was not informed of any risk; my broker kept assuring me nothing was safer. When I asked about redeeming them, he said I’d only need to give him two or three days’ notice to redeem.”

She said she has tried to get help from authorities in her home state of Massachusetts, in Texas and also at the Securities and Exchange Commission. She has received sympathy but little else. A spokeswoman for UBS confirmed that former clients were not all covered by the settlement agreement it struck with regulators.

“Investors who moved their relationships away from UBS while liquidity for auction-rate securities was still available through the auction process are not eligible for our settlement offering, as they were no longer using a UBS financial adviser for investment advisory or brokerage services at the time that auctions failed,” said Karina Byrne, the spokeswoman. “We believe our settlement covers more auction-rate securities holders because it covers all UBS clients who were holding the securities, regardless of where they purchased them, and our settlement is the only one that covers retail, corporate and institutional holders.”

Another victim of the auction-rate morass is Jeff Stier, associate director of the American Council on Science and Health, a nonprofit organization in New York. He, too, invested in auction-rate securities through UBS. The investments were to help fund his organization’s \$2 million budget.

Mr. Stier said he grew unhappy with the service at the firm and moved his account to a new financial adviser who used Fidelity Investments as a custodian. As was the situation for Ms.

Scharf, the timing of his account shift means that he does not qualify for redemption by either firm, in his case UBS or Fidelity.

An offer made by Fidelity to redeem its clients' securities is limited to customers who bought the securities there prior to Feb. 13, 2008, explained Adam Banker, a spokesman. The buyback offer does not extend to customers who bought the securities through other firms or advisers, he said.

The result is that \$250,000 of the nonprofit's money overseen by Mr. Stier is frozen.

"These were marketed to us explicitly as an alternative to money markets for money that UBS knew we needed to have relatively liquid," Mr. Stier said. "We are getting to the point where we may soon need additional funds. We are at the verge of having a material loss as a result of lack of liquidity."

Why did securities regulators agree to settlement terms with UBS and other firms that wound up shutting some investors out? **William F. Galvin**, the secretary of the Commonwealth of Massachusetts and the regulator who secured the deal with UBS, said that the Oct. 1, 2007, redemption starting point was based on the date that officials concluded UBS knew the auctions were beginning to fail.

"If we could have proved that they knew two years beforehand, we would have attached liability to that period," Mr. Galvin said. "Our goal was to get people out, and out as promptly as possible."

Still, he said that he was interested in trying to help investors who were stuck in the securities. "I recognize the fact that this problem is not completely solved," Mr. Galvin said, "and we need to keep working on it until we free up everybody."

This predicament is like so many of the messes created by Wall Street in recent years: Easy to make. Hard to fix.

*Shepherd Smith Edwards & Kantas is continuing to represent clients who were not eligible for the buyback and/or are seeking to secure consequential damages as a result of the brokerage firm's actions in the ARS debacle. If you believe you have suffered consequential damages, or were not eligible for a buyback, please feel free to contact us, its not too late to file a claim.*

*Over these past several months we have enjoyed speaking with you. We hope our information and analysis, both in direct conversation and via the Newsletter, has been helpful during these doubtful times. As always, if anyone has any questions, feel free to contact us at 800-259-9010, or at [ksmith@sselaw.com](mailto:ksmith@sselaw.com) or [sedwards@sselaw.com](mailto:sedwards@sselaw.com)*