

1 ADMINISTRATIVE PROCEEDING

2 BEFORE THE

3 SECURITIES COMMISSIONER OF SOUTH CAROLINA

4 In the matter of:

5 WACHOVIA SECURITIES, LLC, )  
6 and )  
7 WACHOVIA CAPITAL MARKETS, )  
8 LLC, )  
9 Respondents. )

ADMINISTRATIVE CONSENT ORDER

File Number 08018

10  
11 WHEREAS, Wachovia Securities, LLC<sup>1</sup> ("Wachovia Securities"), is a broker-dealer registered in  
12 the State of South Carolina with its home office at One North Jefferson Avenue, St. Louis, Missouri, and  
13 Wachovia Capital Markets, LLC ("Wachovia Capital Markets"), collectively with Wachovia Securities,  
14 "Wachovia"<sup>2</sup>), is a broker-dealer with its home office at 301 South College Street, Charlotte, North  
15 Carolina; and

16 WHEREAS, a multi-state task force conducted and coordinated investigations into Wachovia's  
17 marketing and sale of auction rate securities to investors during the period of January 1, 2006, through  
18 February 14, 2008; and

19 WHEREAS, after a books and records inspection by a multi-state task force on July 17, 2008,  
20 Wachovia Securities has cooperated fully with regulators conducting the investigations by responding to  
21 inquiries, providing documentary evidence and other materials, and providing regulators with access to  
22 information relating to the investigations; and

23 WHEREAS, Wachovia has advised regulators of its agreement to resolve the investigations  
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25 <sup>1</sup> In October 2007, Wachovia Corporation acquired the Missouri-based broker dealer A. G. Edwards & Sons, Inc.  
26 ("AG Edwards") which was subsequently combined with Wachovia Securities, LLC.

<sup>2</sup> Factual allegations in this Order may apply to Wachovia Securities and/or Wachovia Capital Markets, but do not necessarily refer to both entities.

1 relating to its marketing and sale of auction rate securities to investors; and

2 WHEREAS, Wachovia agrees to, among other things, reimburse certain purchasers of auction  
3 rate securities, and to make certain payments at the direction of the Securities Commissioner of the State  
4 of South Carolina (the "Securities Commissioner"); and

5 WHEREAS, Wachovia elects to permanently waive any right to a hearing and appeal under S.C.  
6 Code Ann. §§35-1-604 and 35-1-609 (Supp. 2008) with respect to this Consent Order (the "Order");

7 NOW, THEREFORE, the Securities Commissioner, as administrator of the South Carolina  
8 Uniform Securities Act of 2005 (the "Act"), hereby enters this Order.

9 I.

10 **FINDINGS OF FACT**

11 1. Wachovia Securities admits the jurisdiction of the Securities Commissioner and  
12 Wachovia Capital Markets consents to the jurisdiction of the Securities Commissioner for purposes of  
13 this Order. Neither admits nor denies the Findings of Fact and Conclusions of Law contained in this  
14 Order, and each consents to the entry of this Order by the Securities Commissioner.

15 2. Auction rate securities are long-term debt or equity instruments that include auction  
16 preferred shares of closed-end funds, municipal auction rate bonds, and various asset-backed auction rate  
17 bonds (collectively referred to herein as "ARS"). While ARS are all long-term instruments, one  
18 significant feature of ARS (which historically provided the potential for short-term liquidity) is the  
19 interest/dividend reset through auctions that occur in varying increments of between 7 and 42 days. If an  
20 auction is successful, investors are able to exit the ARS market on a short-term basis. If, however, an  
21 auction "fails," investors are required to hold all or some of their ARS until the next successful auction in  
22 order to liquidate their funds. Beginning in February 2008, the ARS market experienced widespread  
23 failed auctions.

24 3. In early March 2008, Wachovia Securities' investors, unable to access their ARS funds,  
25 began to submit complaints to the Securities Commissioner. Through investigation it was determined that  
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1 during the period January 1, 2006, through February 14, 2008, ARS totaling over one hundred ninety  
2 three million dollars (\$193,000,000) were sold to South Carolina investors.

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

4 4. In connection with the sale of ARS, some of the South Carolina investors have indicated  
5 that they were told by Wachovia Securities and its registered agents that ARS were:

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

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

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

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

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

9 8. Wachovia and its registered securities agents were, or should have been, aware that the  
10 ARS market was suffering from increasing failures and liquidity issues, and they should have disclosed  
11 those facts to investors who were purchasing auction rates after such issues arose. Based on these facts,  
12 Wachovia engaged in dishonest and unethical practices in the marketing and sale of ARS. Pursuant to  
13 S.C. Code Ann. §35-1-412(d)(13) (Supp. 2008), these practices constitute grounds to revoke Wachovia's  
14 registration. These practices included, among other things, the following:

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

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

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

22 **Temporary Maximum Rate Waiver on Certain ARS**

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

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

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

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

17 a. the ARS interest rates could not be reset at a level that would prevent a failed  
18 auction absent the maximum rate waiver; and

19 b. the high interest rate allowed by the waiver would expire at the end of the  
20 waiver period unless extended by the issuer.

21 Pursuant to S.C. Code Ann. § 35-1-412(d)(13) (Supp. 2008), these practices constitute grounds to revoke  
22 Wachovia Securities' registration.

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

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

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

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

15 16. Wachovia Securities failed to reasonably supervise its employees, which is grounds for  
16 revocation of its registration under S.C. Code Ann. § 35-1-412(d)(9) (Supp. 2008) by:

17 a. failing to provide adequate training to its registered agents regarding ARS  
18 by, among other things:

19 i. failing to provide timely and comprehensive sales and marketing  
20 literature regarding ARS and the mechanics of the auction process;

21 ii. failing to provide pertinent information concerning the complexity of the  
22 ARS product; and

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

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

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

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

6 **II.**

7 **CONCLUSIONS OF LAW**

8 17. The Securities Commissioner has jurisdiction over this matter pursuant to S.C. Code §35-  
9 1-604 (Supp. 2008).

10 18. The Securities Commissioner finds Wachovia Securities failed to supervise its employees  
11 and engaged in dishonest or unethical practices in the securities business, and that this conduct constitutes  
12 grounds to revoke Wachovia Securities' registration under S.C. Code Ann. §§ 35-1-412(d)(9) & (13)  
13 (Supp. 2008).

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

16 **III.**

17 **ORDER**

18 On the basis of the Findings of Fact, Conclusions of Law, and Wachovia's consent to the entry of  
19 this Order, IT IS HEREBY ORDERED:

20 1. This Order concludes the investigation by the Securities Commissioner and any other  
21 action the Securities Commissioner could commence under applicable South Carolina law on behalf of the  
22 State of South Carolina as it relates to Wachovia's marketing and sale of auction rate securities to investors.

23 2. This Order is entered into solely for the purpose of resolving the referenced multi-state  
24 investigation and is not intended to be used for any other purpose.

1           3.       Wachovia will CEASE AND DESIST from violating the Act and will comply with the Act.

2           4.       Wachovia shall pay the sum of seven hundred seventy two thousand nine hundred fifty  
3 eight dollars and three cents (\$772,958.03) to the Securities Division of the Office of the Attorney  
4 General of the State of South Carolina, such payment to be received as follows: four hundred  
5 thousand dollars (\$400,000.00) within thirty days from the entry of this Order and the remainder  
6 at any time during the period beginning August 1, 2009, and concluding December 31, 2009.

7           5.       In the event another state securities regulator determines not to accept Wachovia's state  
8 settlement offer, the total amount of the South Carolina payment shall not be affected and shall remain at  
9 \$772,958.03.

10          6.       Wachovia Securities and Wachovia Capital Markets, respectively, as agents for one or  
11 more affiliated companies and not as principal, shall offer to purchase at par ARS that are subject to  
12 auctions that are not successful and are not subject to current calls or redemptions ("Eligible ARS") from  
13 all investors in the Relevant Class. For purposes of this Order the "Relevant Class" shall be defined as all  
14 investors who purchased ARS from either Wachovia Securities or Wachovia Capital Markets,  
15 respectively, on or before February 13, 2008 into accounts maintained at Wachovia Securities or  
16 Wachovia Capital Markets, respectively.

17           a.       Wachovia Securities and Wachovia Capital Markets, as agents for one or more  
18 affiliated companies and not as principal, shall make an offer to buy the Eligible ARS from  
19 Individual Investors, as defined below, who are in the Relevant Class. This buy back shall  
20 commence no later than November 10, 2008 and conclude no later than November 28, 2008. For  
21 purposes of this Order, "Individual Investors" shall include natural persons, individual retirement  
22 accounts and the following entities or accounts:

- 23                   i.       Accounts with the following owners:
- 24                           1.       non-profit charitable organizations; and
- 25                           2.       religious corporations.
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1                   ii.       Accounts with the following owners and with account values or  
2 household values up to \$10 million:

- 3                   1.       trusts;  
4                   2.       corporate trusts;  
5                   3.       corporations;  
6                   4.       employee pension plans/ERISA and Taft Hartley Act plans;  
7                   5.       educational institutions;  
8                   6.       incorporated non-profit organizations;  
9                   7.       limited liability companies;  
10                  8.       limited partnerships;  
11                  9.       non-public companies;  
12                  10.      partnerships;  
13                  11.      personal holding companies;  
14                  12.      unincorporated associations; and  
15                  13.      governmental and quasi-government entities.

16                  b.       Wachovia Securities and Wachovia Capital Markets as agent for one or more  
17 affiliated companies and not as principal, shall commence a buy back of the Eligible ARS from  
18 all other investors in the Relevant Class not otherwise covered by subparagraph a, above, no later  
19 than June 10, 2009 and conclude no later than June 30, 2009.

20                  7.       No later than November 28, 2008, Wachovia shall pay any investor in the Relevant Class  
21 who sold ARS below par between February 13, 2008, and August 15, 2008, and whom Wachovia can  
22 reasonably identify, the difference between par and the price at which the investor sold the ARS.

23                  8.       Wachovia shall notify all investors in the Relevant Class of the provisions of this Order  
24 as provided in paragraphs 9 and 10.

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

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

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

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

22 12. Wachovia Securities shall establish and maintain a dedicated telephone assistance line,  
23 with appropriate staff, to respond to questions from investors concerning the terms of this Order and  
24 Wachovia's no net cost loan (nonrecourse, no release) program. Wachovia Securities shall maintain this  
25 dedicated telephone assistance line through June 30, 2009.

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

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

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

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

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

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

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

22          15.     If Wachovia defaults in any of its obligations set forth in this Order, the Securities  
23 Commissioner may vacate this Order, at his sole discretion, upon 10 days notice to Wachovia and without  
24 opportunity for administrative hearing or may refer this matter for enforcement as provided in S.C. Code  
25 Ann. §35-1-604 (Supp. 2008).

1           16.     This Order is not intended to indicate that Wachovia or any of its affiliates or current or  
2 former employees shall be subject to any disqualifications contained in the federal securities law, the rules  
3 and regulations thereunder, the rules and regulations of self regulatory organizations or various states'  
4 securities laws including any disqualifications from relying upon the registration exemptions or safe  
5 harbor provisions. In addition, this Order is not intended to form the basis for any such disqualifications.

6           17.     This Order may not be read to indicate that Wachovia or any of its affiliates or current or  
7 former employees engaged in fraud or violated any federal or state laws, the rules and regulations  
8 thereunder, or the rules and regulations of self regulatory organizations.

9           18.     For any person or entity not a party to this Order, this Order does not limit or create any  
10 private rights or remedies against Wachovia including, without limitation, the use of any e-mails or other  
11 documents of Wachovia or of others for the marketing and sale of auction rate securities to investors, limit or  
12 create liability of Wachovia, or limit or create defenses of Wachovia to any claims.

13           19.     This Order shall not disqualify Wachovia or any of its affiliates or current or former  
14 employees from any business that they otherwise are qualified or licensed to perform under applicable  
15 state law and this Order is not intended to form the basis for any disqualification.

16           20.     Nothing herein shall preclude the State of South Carolina, its departments, agencies, boards,  
17 commissions, authorities, political subdivisions and corporations, other than the Securities Commissioner  
18 and only to the extent set forth in paragraph 1 above, (collectively, "State Entities") and the officers, agents or  
19 employees of State Entities from asserting any claims, causes of action, or applications for compensatory,  
20 nominal and/or punitive damages, administrative, civil, criminal, or injunctive relief against Wachovia in  
21 connection with the marketing and sale of auction rate securities at Wachovia.

22           21.     Wachovia shall pay its own costs and attorneys' fees with respect to this matter.  
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Dated this 13<sup>th</sup> day of April, 2009.

BY ORDER OF THE SECURITIES COMMISSIONER



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HENRY D. McMASTER  
SECURITIES COMMISSIONER  
STATE OF SOUTH CAROLINA

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Title: Eder VP

Wachovia Capital Markets, LLC

By: \_\_\_\_\_

Title: \_\_\_\_\_

SUBSCRIBED AND SWORN TO before me this 25 day of March, 2009.

Hollis H. Carroll  
Notary Public

My commission expires:  
7/5/2009



CONSENT TO ENTRY OF ADMINISTRATIVE ORDER BY WACHOVIA

1  
2 Wachovia hereby acknowledges that it has been served with a copy of this Consent Order, has read  
3 the foregoing Order, is aware of its right to a hearing and appeal in this matter, and has waived the same.

4 Wachovia Securities admits the jurisdiction of the Securities Commissioner and Wachovia Capital  
5 Markets consents to the jurisdiction of the Securities Commissioner for purposes of this Order. Neither  
6 Wachovia Securities nor Wachovia Capital Markets admits or denies the Findings of Fact and Conclusions of  
7 Law contained in this Order; and each consents to entry of this Order by the Securities Commissioner as  
8 settlement of the issues contained in this Order.

9 Wachovia states that no promise of any kind or nature whatsoever was made to it to induce it to enter  
10 into this Order and that it has entered into this Order voluntarily.

11 \_\_\_\_\_ represents that he/she is \_\_\_\_\_ of Wachovia  
12 Securities, LLC and that, as such, has been authorized by Wachovia Securities, LLC to enter into this Order  
13 for and on behalf of Wachovia Securities, LLC.

14 Barbara Wright represents that he/she is SVP of Wachovia Capital  
15 Markets, LLC and that, as such, has been authorized by Wachovia Capital Markets, LLC to enter into this  
16 Order for and on behalf of Wachovia Capital Markets, LLC.

17 Wachovia agrees that it shall not claim, assert, or apply for a tax deduction or tax credit with  
18 regard to any state, federal or local tax for any administrative monetary penalty that Wachovia shall pay  
19 pursuant to this Order.

20 Dated this 26 day of March, 2009.

21  
22 Wachovia Securities, LLC

23  
24 By: \_\_\_\_\_



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Title: \_\_\_\_\_

Wachovia Capital Markets, LLC

By: Baluyut

Title: SVP

SUBSCRIBED AND SWORN TO before me this 26<sup>th</sup> day of March, 2009.

Chanise Stokes Collins  
Notary Public

My commission expires:

June 10, 2011

