

1 THE PEOPLE OF THE STATE OF CALIFORNIA  
2 BY AND THROUGH THE COMMISSIONER OF CORPORATIONS

3  
4 In the matter of: )  
5 )  
6 WACHOVIA SECURITIES, LLC; )  
7 One North Jefferson Avenue )  
8 St. Louis, Missouri 63103 )  
9 and )  
10 WACHOVIA CAPITAL )  
11 MARKETS, LLC, )  
12 301 S. College Street )  
13 TW-8, Mail Code NC0602 )  
14 Charlotte, North Carolina 28288- )  
15 0601 )  
16 Respondents. )  
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**FINDINGS OF FACT**  
**CONCLUSIONS OF LAW**  
**ADMINISTRATIVE CONSENT ORDER**

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

20 WHEREAS, a multi-state task force conducted and coordinated investigations into  
21 Wachovia’s marketing and sale of auction rate securities to investors during the period of January 1,  
22 2006, through February 14, 2008; and

23 WHEREAS, after a books and records inspection by a multi-state task force on July 17, 2008,  
24 Wachovia Securities has cooperated fully with regulators conducting the investigations by responding  
25 to inquiries, providing documentary evidence and other materials, and providing regulators with

26 \_\_\_\_\_  
27 <sup>1</sup> In October 2007, Wachovia Corporation acquired the Missouri-based broker dealer A. G. Edwards & Sons, Inc. (“AG  
28 Edwards”) which was subsequently combined with Wachovia Securities, LLC.

1 access to information relating to the investigations; and

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

4 WHEREAS, Wachovia agrees to, among other things, reimburse certain purchasers of auction  
5 rate securities, and to make certain payments at the direction of the California Department of  
6 Corporations; and

7 WHEREAS, Wachovia elects to permanently waive any right to a hearing and appeal under  
8 California Corporations Code sections 25532(d) and 25609 with respect to this Consent Order (the  
9 “Order”);

10 NOW, THEREFORE, the California Department of Corporations, as administrator of the  
11 California Corporate Securities Laws hereby enters this Order.

12 **I.**

13 FINDINGS OF FACT

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

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  
21 rate 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.  
24 If an auction is successful, investors are able to exit the ARS market on a short-term basis. If,  
25 however, an auction “fails,” investors are required to hold all or some of their ARS until the next  
26 successful auction in order to liquidate their funds. Beginning in February 2008, the ARS market

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28 <sup>2</sup> Factual allegations in this Order may apply to Wachovia Securities and/or Wachovia Capital Markets, but do not

1 experienced widespread failed auctions.

2           3.       In early March 2008, Wachovia Securities' investors, unable to access their ARS  
3 funds, began to submit complaints to the California Department of Corporations. California Investors  
4 at that time had ARS holdings totaling over \$1,554,902,000.00, which were purchased from  
5 Wachovia Securities.

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

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

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

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

24           5.       Wachovia Securities further fostered the misconception that ARS were cash-like  
25 instruments by providing account portfolio summaries to certain of its customers that listed ARS as  
26 "cash equivalents." In fact, ARS were not "cash equivalents" and full liquidity was only available at  
27

28 necessarily refer to both entities.

1 an auction if the auction was successful.

2 6. Although Wachovia Securities sold ARS as conservative, safe, and liquid investments  
3 to its investors until February 2008, Wachovia had information that several auctions had failed in  
4 August 2007 and early 2008, before the mass failures in February 2008. During this same period of  
5 time, Wachovia failed to inform its customers purchasing ARS after such auctions began to fail that  
6 certain auctions would have failed had Wachovia or another broker-dealer not entered support bids in  
7 those 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  
13 disclosed those facts to investors who were purchasing auction rates after such issues arose. Based  
14 on these facts, Wachovia engaged in a manipulative or deceptive scheme, device or contrivance with  
15 regard to inducing the purchase or sale of securities in violation of California Corporations Code  
16 section 25216(a) with regard to the sale of ARS. These practices constitute grounds to revoke  
17 Wachovia's registration under the California Corporations Code. These practices included, among  
18 other things, the following:

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

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

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

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

28 9. The interest rates on ARS are reset periodically through the auction process. In the

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

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

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

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

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

21 b. that the high interest rate allowed by the waiver would expire at the end of the  
22 waiver period unless extended by the issuer.

23 13. These practices amount to a manipulative or deceptive scheme, device or contrivance  
24 with regard to inducing the purchase or sale of securities in violation of California Corporations Code  
25 section 25216(a) and provide grounds to revoke Wachovia Securities’ registration under California  
26 Corporations Code section 25212.

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

28 14. Although ARS are complicated and complex products, Wachovia Securities did not

1 provide its sales or marketing staff with the training and information necessary to adequately explain  
2 these products or the mechanics of the auction process to their customers. During the course of  
3 investigations, on-the-record statements taken from Wachovia Securities' registered agents  
4 demonstrated that these agents lacked a basic understanding of the functionality of the ARS products  
5 and the auction rate market.

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

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

16 17. Wachovia Securities failed to reasonably supervise its employees, in violation of Title  
17 10, Ch. 3, section 260.218.4(a) of the California Code of Regulations, which is grounds for  
18 revocation of its registration under California Corporations Code section 25212 due to:

- 19 a. failing to provide adequate training to its registered agents regarding ARS by,  
20 among other things:
- 21 i. failing to provide timely and comprehensive sales and marketing  
22 literature regarding ARS and the mechanics of the auction process;
  - 23 ii. failing to provide pertinent information concerning the complexity of  
24 the ARS product; and
  - 25 iii. failing to ensure that its agents were selling ARS to individual investors  
26 for whom they were suitable; and
- 27 b. failing to review account portfolio statements sent to its customers to ensure  
28 that they reflected accurate information regarding ARS;

- c. failing to review ARS transactions in accounts of customers who needed liquidity; and
- d. failing to ensure that its registered personnel were providing adequate information regarding ARS to its customers.

**II.**

**CONCLUSIONS OF LAW**

18. The California Department of Corporations has jurisdiction over this matter pursuant to the California Corporate Securities Laws and because Wachovia is and, at all times relevant to this order, was registered in California as a broker-dealer.

19. The California Department of Corporations finds Wachovia Securities failed to supervise its employees in violation of Title 10, Ch. 3, section 260.218.4(a) of the California Code of Regulations and engaged in a manipulative or deceptive scheme, device or contrivance with regard to inducing the purchase or sale of securities, in violation of California Corporations Code section 25216(a) and that this conduct constitutes grounds to revoke Wachovia Securities' registration under California Corporations Code section 25212.

20. The California Department of Corporations finds this order and the following relief appropriate, in the public interest, and consistent with the purposes intended by the California Corporate Securities Laws.

**III.**

**ORDER**

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

IT IS HEREBY ORDERED:

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

2. This Order is entered into solely for the purpose of resolving the referenced multi-state

1 investigation, and is not intended to be used for any other purpose.

2 3. Wachovia will CEASE AND DESIST from violating California Corporations Code  
3 section 25216(a) by engaging in a manipulative or deceptive scheme, device or contrivance with  
4 regard to inducing the purchase or sale of securities, and Title 10, Ch. 3, section 260.218.4(a) of the  
5 California Code of Regulations by failing to supervise its employees with regard to the sale of  
6 securities, and will hereafter comply with those sections with regard to the marketing and sale of  
7 auctions rate securities to investors.

8 4. Within ten days after the entry of this Order, Wachovia shall pay administrative  
9 penalties pursuant to California Corporations Code section 25252, in the sum of Five Million Five  
10 Hundred and Seven Thousand Eight Hundred Twenty Four Dollars and Fifty Cents, (\$5,507,824.50)  
11 to the California State Corporations Fund.

12 5. In the event another state securities regulator determines not to accept Wachovia's  
13 state settlement offer, the total amount of the California payment shall not be affected, and shall  
14 remain at \$5,507,824.50.

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

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



- 1                   i.       Accounts with the following owners:
  - 2                   1.       non-profit charitable organizations; and
  - 3                   2.       religious corporations.
- 4                   ii.       Accounts with the following owners and with account values or
- 5                   household values up to \$10 million:
  - 6                   1.       trusts;
  - 7                   2.       corporate trusts;
  - 8                   3.       corporations;
  - 9                   4.       employee pension plans/ERISA and Taft Hartley Act plans;
  - 10                  5.       educational institutions;
  - 11                  6.       incorporated non-profit organizations;
  - 12                  7.       limited liability companies;
  - 13                  8.       limited partnerships;
  - 14                  9.       non-public companies;
  - 15                  10.      partnerships;
  - 16                  11.      personal holding companies;
  - 17                  12.      unincorporated associations; and
  - 18                  13.      governmental and quasi-government entities.

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

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

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

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  
4 account as of August 31, 2008. For purposes of the Order, "Required Notification" shall mean a  
5 notice that 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  
11                ARS

12                holdings may not be liquid and that there is a possibility that this offer may be the only  
13                opportunity for the investor to liquidate the ARS holdings; and

14           f.       a statement that the offer to repurchase the ARS holdings, and other relief  
15                specified in the Order, is being made pursuant to a settlement with state securities regulators.

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

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

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

28          13.       With respect to any claim for consequential damages, to the extent such claims are not

1 resolved informally by Wachovia, Wachovia shall arbitrate the claim of any Relevant Class member  
2 who elects to arbitrate, pursuant to the following provisions:

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

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

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

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

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

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

21 15. If Wachovia defaults in any of its obligations set forth in this Order, the California  
22 Department of Corporations may vacate this Order, at its sole discretion, upon 10 days notice to  
23 Wachovia and without opportunity for administrative hearing or may refer this matter for  
24 enforcement as provided in the California Corporate Securities Laws.

25 16. This Order is not intended to indicate that Wachovia or any of its affiliates or current  
26 or former employees shall be subject to any disqualifications contained in the federal securities law,  
27 the rules and regulations thereunder, the rules and regulations of self regulatory organizations or  
28 various states' securities laws including any disqualifications from relying upon the registration

1 exemptions or safe harbor provisions. In addition, this Order is not intended to form the basis for any  
2 such disqualifications.

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

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

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

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

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

21  
22 Dated this 9<sup>th</sup> day of March, 2009.

23 PRESTON DuFAUCHARD  
24 California Corporations Commissioner

25 By \_\_\_\_\_  
26 ALAN S. WEINGER  
27 Lead Corporations Counsel  
28 Enforcement Division

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**CONSENT TO ENTRY OF ADMINISTRATIVE ORDER BY WACHOVIA**

Wachovia hereby acknowledges that it has been served with a copy of this Consent Order, has read the foregoing Order, is aware of its right to a hearing and appeal in this matter pursuant to California Corporations Code sections 25532(d) and 25609, and has waived the same.

Wachovia Securities admits the jurisdiction of the California Department of Corporations and Wachovia Capital Markets consents to the jurisdiction of the California Department of Corporations for purposes of this Order. Neither Wachovia Securities nor Wachovia Capital Markets admits or denies the Findings of Fact and Conclusions of Law contained in this Order; and each consents to entry of this

1 Order by the Commissioner as settlement of the issues contained in this Order.

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

4 Doug Kelly represents that he/she is General Counsel of Wachovia  
5 Securities, LLC and that, as such, has been authorized by Wachovia Securities, LLC to enter into this  
6 Order for and on behalf of Wachovia Securities, LLC.

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

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

13 Dated this 25 day of February, 2009.

15 Wachovia Securities, LLC

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

18 Title: General Counsel

22 Wachovia Capital Markets, LLC

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

26 Title: SVP

28 SUBSCRIBED AND SWORN TO before me this \_\_\_\_\_ day of \_\_\_\_\_, 2009.

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Notary Public

My commission expires:

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