Auction-Rate Securities: A Fast & (and) Furious Fall

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Auction-Rate Securities: A Fast & Furious Fall

I. INTRODUCTION

An owner of a laser-surgery business who lost access to more than ninety percent of his life savings after his UBS broker marketed “cash-equivalent” securities with no “market risk,” a law professor unable to liquidate $75,000 of invested money to pay for her sons’ pending tuition bills and a Chicago hospital whose interest payments increased by more than fifty percent on securities issued to raise money have one thing in common. Each are victims of the collapse of the auction-rate securities market, stunning both in the unprecedented size of a market brought to its knees and the rapidity at which it collapsed. The $330 billion market for auction-rate securities imploded in early February 2008. Auction-rate securities are variable-interest rate, long-term securities that were marketed to individual, retail investors and institutional investors as cash equivalents by many of Wall Street’s leading financial institutions. The fundamental design of auction-rate securities, however, demonstrates that they are not cash

1. Peter Caronara, Nonprofits Feel the Debt Squeeze Too, BUS. WK., Nov. 17, 2008, at 77 (discussing Swedish Covenant Hospital in Chicago's increased interest payments on auction-rate securities that it issue); Gretchen Morgenson, It's a Long, Cold, Cashless Siege, N.Y. TIMES, Apr. 13, 2008, at C2, available at 2008 WLNR 6899702 [hereinafter Cashless Siege] (discussing the plight of Craig Joffe, the Minnesota business-owner who has unexpectedly lost liquidity in more than ninety percent of his investments after a UBS broker invested in auction-rate securities); Gretchen Morgenson, The Investors Who Can't Come In From the Cold, N.Y. TIMES, Nov. 30, 2008, at BU1, available at 2008 WLNR 22925632 [hereinafter Come In From The Cold] (discussing the situation of Irene Scharf, a Massachusetts law professor, who can’t liquidate $75,000 of auction-rate securities earmarked to pay for her sons' tuition bills).

2. Supra note 1 and accompanying text.


4. Cherdack et al., supra note 3.
Liquidity in the auction-rate securities market is dependent on the number of willing sellers being equaled or exceeded by the number of willing buyers. To maintain liquidity, financial institutions bid on their own securities, creating a false sense of demand in the minds of investors. Brokers’ failure to disclose to potential investors that an adequate level of demand was often achieved only after the issuing financial institutions bid on the securities themselves to prevent an auction failure became common practice. Also, investors were not informed that financial institutions were not bound to place such supporting bids and that without such voluntary support, the viability of the market and the liquidity of the securities would be in jeopardy. Such conduct by the financial institutions that issued auction-rate securities and managed auctions likely exposed them to liability for deception or misrepresentation, grounds for civil fraud claims. State Attorneys General, the Securities and Exchange Commission [hereinafter SEC], and the Financial Industry Regulatory Authority [hereinafter FINRA] launched investigations into the practice of auction-rate securities issuers. These investigations have resulted in criminal charges as well as civil lawsuits by both individual investors and state Attorneys General and large pre-trial settlements. Such settlements have usually restored liquidity to retail, charitable organization and small business clients while exempting larger institutional investors. A few suits have been filed by both individual and institutional investors. The good news for both investors who

5. Id.
6. Id.
7. Id.
8. Id.
9. Id.
10. Cathy Lockman, The Collapse of the Auction Rate Market, PERSP., Fall 2008, 8, 10, http://www.business.illinois.edu/publications/perspectives/2008-fall.pdf (noting that the type of misrepresentation that issuing financial institutions are accused of may be grounds for civil fraud); Cherdack et. al., supra note 3.
11. Cherdack et al., supra note 3.
12. Id.
13. Infra notes 203-217 and accompanying text.
wish to liquidate their holdings and issuing financial institutions concerned about the costs of liability is that the underlying value of the securities have not been affected by the collapse of demand. While seemingly legitimate claims that brokers wrongfully misrepresented the safety of auction-rate securities are common, a coordinated public-private approach to settling claims and restoring liquidity has prevented a flood of litigation claims by investors and allowed for a slow but orderly restoration of liquidity for many investors.

II. OVERVIEW OF THE AUCTION-RATE SECURITIES MARKET

A. The Appeal of Auction-Rate Securities

Auction-rate securities were developed in the early 1980s to satisfy demand for advantageous investment products in a market constrained by high inflation rates. American Express debuted auction-rate securities in July 1984. The variable interest-rate component of auction-rate securities provided issuers lower financing costs by continually matching interest rates to market conditions. In October 2007, auction-rate securities' interest rates were as low as 3.66 percent. In effect, this provided issuers short-term interest rates for long-term debt. A typical

institutional investors against UBS which survived a motion to dismiss); Daniel C. Girard, Billions to Answer For, LEGAL TIMES, Sept. 15, 2008, available at http://www.girardgibbs.com/legaltimes.pdf (discussing the relatively low number of individual investors suits related to the collapse of the auction-rate securities market and the potential for additional suits to be filed despite the large settlements); Brendan Pierson, Class Action Launched Against H&R Block Over ARS, LAW360, Sept. 25, 2008, http://www.law360.com (discussing a class action suit filed against H&R Block).

15. Cherdack et al., supra note 3.
16. Id.
17. Lee, supra note 3.
18. Id.
19. Id.
21. Id. (“Auction rate bonds offered issuers an attractive cost of financing, ..., a maturity of thirty-years or longer, and the flexibility to call the bond at any time.”); John Fazio et al., The Genesis of a Troubled Product: Auction Rate Securities, PRACTICING LAW INST., Aug. 6, 2008, available at Westlaw, 1686 PLI/Corp325 (“By
auction-rate securities’ term is twenty to thirty years. However, some auction-rate securities are perpetual. Such securities, primarily those issued by closed-end mutual funds, comprise roughly twenty-five percent of the auction-rate securities market. For investors, auction-rate securities were beneficial as they paid an interest rate that was, on average, roughly one percentage point more than money market funds.

Dealing in auction-rate securities was a profitable business for many financial institutions. Issuing the securities generated substantial fees for investment banking customers, usually 1.5 percent of the amount of money raised. Banks also generated funds, usually twenty-five basis points annually, for managing the auctions. Furthermore, each time clients bought and sold the securities in the auction process, issuing banks earned additional fees.

B. Types of Auction-Rate Securities

Auction-rate securities are often referred to by different names based on the type of issuer: “Auction Market Preferred Stock,” “Variable Rate Preferred Securities,” “Money Market Preferred Securities,” and “Periodic Auction Rate Securities.” The bulk of the auction-rate securities market is composed of three types of issuers. At the end of 2007, fifty percent of auction-rate securities were issued by municipalities in the form of

agreeing to a regular and frequent schedule of matching interest rates with market conditions through an auction process, lenders became willing to acquire long-term debt from borrowers in return for the payment of interest at short-term rates.”

22. Cherdack et al., supra note 3.
23. Lee, supra note 3.
24. Id.
26. Infra notes 27-29 and accompanying text.
27. Cherdack et al., supra note 3; Cashless Siege, supra note 1.
28. Cashless Siege, supra note 1.
29. Cherdack et al., supra note 3.
31. Melvin & Duffield, supra note 3.
bonds. Another twenty-six percent were auction-rate bonds issued by student loan lenders. Nineteen percent were "preferred equity instruments" or auction-rate preferred securities, primarily issued by closed-end mutual funds. Such funds issued auction-rate securities to enhance returns for common shareholders by leveraging the portfolio. Investors earned the "spread" between the returns of the portfolio and the rate paid to auction-rate securities holders. The remaining five percent of the auction-rate securities market includes issuers such as corporations and collateralized debt obligations.

C. Size of the Auction-Rate Securities Market

The size of the auction-rate securities market grew exponentially in recent years to approximately $330 billion in early 2008. Several years ago, banks expanded their market by lowering the minimum investment requirement for auction-rate securities from $250,000 to $25,000. This shift opened the market to a wide array of retail investors. Furthermore, beginning in 2005, pressure from accounting firms and the SEC to stop listing auction-rate securities as "cash equivalents" on financial statements caused many corporations to decrease the size of their auction-rate securities holdings. Consequently, banks began to market auction-rate securities more aggressively to retail investors, who frequently failed to understand the nature of the financial product they were purchasing.

32. *Id.*
33. *Id.*
34. *Id.*
36. *Id.*
38. Cherdack et al., *supra* note 3.
40. Cherdack et al., *supra* note 3.
42. *Id.*
D. The Auction Process

Investors purchase auction-rate securities at par value when they are issued. Subsequently, interest-rates are reset via a type of auction known as a “Dutch auction.” Auctions are held every seven, twenty-eight, thirty-five or forty-nine days and are facilitated by either the issuing bank or another financial institution. Customarily, broker-dealers survey the market prior to each auction and provide advice, known as “price talk,” to their clients regarding their belief as to what interest rate is likely to be set at the next auction. An interested investor may place a “buy” order for auction-rate securities at a given interest rate. The investor is committing to purchase the securities as long as the clearing rate is set at or above the investor’s required level.

Current holders of auction-rate securities can place three types of orders. First, a holder can place a sell order ordering his broker to sell his securities regardless of the auction’s clearing rate. Second, a holder can tell his broker that he wishes to continue to hold the securities regardless of the clearing rate. Finally, a holder can issue a “hold-at-rate” order. This last order is an instruction to a broker that holders wish to hold securities only if the clearing rate meets or exceeds a specified rate. Otherwise, the broker will sell the securities.

The clearing-rate is set at the lowest possible interest rate at which all securities up for auction are able to be matched with

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44. Class Action Petition, supra note 43. A “Dutch” auction is an auction “where the price [is] set at an unattractive level and then made more attractive to prospective buyers throughout the course of the auction.” Id.
45. Cherdack et al., supra note 3; Lee, supra note 3.
46. Cherdack et al., supra note 3.
47. Id.
48. Id.
49. Lee, supra note 3.
50. Id.
51. Id.
52. Id.
53. Id.
54. Id.
buyers. Securities are allocated to investors based on the following priority: “(1) Hold Orders; (2) Hold-at-rate and buy bids with a rate below the clearing rate; (3) Hold-at-rate orders with a rate at the clearing rate; and (4) Buy bids with a rate at the clearing rate.” If there are too many buyers at the clearing rate relative to the available securities, bidders will be allocated securities on a pro-rata basis. Typically, existing holders have priority.

There are two situations in which a clearing-rate is not set: an “all-hold” auction and a failed auction. An “all-hold” auction occurs when all existing holders of the auction-rate securities up for auction want to hold the securities regardless of the interest rate paid. In this case, the interest rate for the next time period reverts to the “all-hold” rate, which is set in the offering prospectus. Usually, this rate is disadvantageous to investors as it tends to be a “below-market rate.”

An auction failure occurs whenever the number of securities demanded by buyers is less than the number of securities up for auction by existing holders. If this occurs, all existing holders who wish to sell are not able to. Should an auction fail, the interest rate for the subsequent time period, until the next auction, reverts to a “penalty” or “maximum rate.” Like the “all-hold” rate, the “penalty” rate is set forth in the prospectus. The “penalty rate” is usually an “above-market” rate, “designed to compensate the investor for this loss of liquidity and to encourage the issuer to redeem or restructure the securities.” The “penalty” rate is either a fixed rate or a specified multiple of a benchmark

55. Cherdack et al., supra note 3.
56. Id.
57. Id.
58. Id.
59. Lee, supra note 3.
60. Id.
61. Id.
62. Id.
63. Id.
64. Id.
65. Lee, supra note 3.
66. Id.
rate such as London Interbank Offered Rate [hereinafter LIBOR]. 68 LIBOR is the rate at which most "creditworthy banks" charge each other for large Eurodollar (U.S. currency held in foreign banks) loans. 69 While receiving the "penalty" rate is more lucrative for the investors than receiving the "all-hold" rate, the investors are unable to liquidate their holdings. 70 The "penalty" rates that investors receive following a failed auction vary widely based on the issuer of a given auction-rate security. 71 Specifically, the "penalty" rates for auction-rate securities issued by municipalities are usually substantially higher than those issued by closed-end mutual funds. 72 For example, following a February 12, 2008, auction failure, the Port Authority of New York and New Jersey was paying interest at a "penalty" rate of twenty percent on one issue of auction-rate securities. 73 Meanwhile, the average "penalty" rate for closed-end funds during March 2008 was only 3.8 percent. 74

The market for auction-rate securities is almost exclusively controlled by the financial institution responsible for managing the auction process. 75 Investors wishing to liquidate their securities have no consistent alternative to the designated auction process. 76 Generally, an auction failure results in both a simultaneous benefit and detriment for the investor. 77 While the investor usually receives the benefit of higher interest payments via the "penalty rate," her investment becomes illiquid for a potentially lengthy period. 78

68. Cherdack et al., supra note 3.
70. Cherdack et al., supra note 3.
71. Lee, supra note 3; Melvin & Duffield, supra note 3.
72. Lee, supra note 3; Melvin & Duffield, supra note 3.
74. Id.
75. Lee, supra note 3.
76. Id.
77. Cherdack et al., supra note 3.
78. Id.
The economic downturn and the tightening of credit markets in 2007 dampened demand for auction-rate securities. Leslie Norwood, Managing Director and Associate General Counsel of the Securities Industry and Financial Markets Association, explained some of the contributing causes of the collapse of the auction-rate securities market to the House Committee on Financial Services:

As problems in the mortgage market spread into the mortgage securitization market in 2007, faith in the monocline insurers who insured mortgage bonds and collateralized debt obligations began to waiver. Investors became wary of being exposed to anything with the potential for downgrades, including any securities insured by the monocline insurers and third-party credit enhanced bonds in general. Because of the critical role the insurers and third party credit enhancers play in the auction rate securities market, demand for ARS began to decline sharply, ultimately resulting in failures across the auction rate securities market; in spite of the fact that the underlying credit ratings of ARS issuers have remained high.

The risk of auction failure increased as the number of buyers decreased to a level where the number of sellers exceeded the number of buyers. Charles Bowsher, former U.S. Comptroller General, blamed the collapse of the auction-rate securities market on the decline in availability of short-term financing: “The auction system is dependent on the availability of short-term financing. When short-term financing seized up and the investment banks didn’t step up to the plate to support the auctions as they had in

79. Lee, supra note 3; Melvin & Duffield, supra note 3.
81. Lee, supra note 3.
the past, the whole system froze.”82 A few auctions failed during late 2007.83 However, most failures were issues that “had less creditworthy issuers.”84 The failures did, however, cause several corporations to write down their auction-rate securities holdings.85 Nevertheless, the rate of auction failure remained low: by the end of 2007 there were only forty-four recorded auction failures since their inception in 1984.86

A. False Auction Support

Often, auction failures were avoided because issuing banks bid on the excess supply of securities, creating “illusory liquidity” in the market.87 For example, from January 2006 until the collapse of the auction-rate securities market in early February 2008, UBS participated in eighty-eight percent of the 30,000 auctions that it managed on behalf of municipalities and student loan agencies.88 However, the frequency with which banks prevented auction failures increased substantially during 2007.89 Such large proprietary purchases placed substantial pressure on banks to resell auction-rate securities to their clients to avoid being stuck with large holdings themselves should market liquidity disappear.90

B. Concern Increased During 2007

Due to increasing market turmoil during 2007, banks sought to decrease their own auction-rate securities holdings to

82. Lockman, supra note 10, at 9.
83. Lee, supra note 3.
84. Id.
85. Id. “Writing down” is an accounting mechanism used by corporations to decrease their tax burden. To achieve this, corporations decrease the value of an asset on their balancing sheet. The corporation simultaneously reports a corresponding loss on their income statement. Id.
86. Id.
87. Cherdack et al., supra note 3 (“Having invested their own capital in the ARS market in order to make a secondary market, broker-dealers had every financial incentive to sell them to their customers.”).
89. Cherdack et al., supra note 3; Melvin & Duffield, supra note 3.
90. See Cherdack et al., supra note 3.
minimize risk. To accomplish this, banks often increased pressure on their brokers to sell the securities to clients, an action that has increased banks' perceived liability after the collapse of the market. Internal communications within UBS, later made public, highlight that conflict. By August 2007, UBS's proprietary auction-rate securities inventory had tripled in five months from $1 billion to $3 billion, concerning the firm's risk managers. One manager e-mailed David Schulman, UBS's Global Head for the Municipal Securities Group, to explain that the firm had "little tolerance for increased inventory" of auction-rate securities. The following week, Shulman held a conference call with 850 brokers to encourage them to promote auction-rate securities to UBS's Wealth Management clients in order to "move more product through the system." In a follow-up e-mail, he implicitly acknowledged the firm's concern about the stability of the auction-rate securities market by stating: "this is our best and most effective way of hedging our exposure." Shulman's skepticism regarding both UBS's ability to continue to prop up the auction-rate securities market with the firm's own cash and the continued viability of the auction-rate securities market was also evidenced by his simultaneous request for clearance from UBS's compliance department to sell nearly $500,000 worth of auction-rate securities from his personal account.

91. Id. See generally Lockman, supra note 10, at 8 (discussing the general theory behind financial institutions' liability for issuing auction-rate securities); Pressman, supra note 88 (discussing UBS executives' concern regarding their exposure to risk in the auction-rate securities market).

92. See, e.g., Pressman, supra note 88 (describing UBS's documented attempt to minimize its own risk by selling auction-rate securities to clients despite knowledge of potential turmoil in the market).

93. Id.

94. Id. at 23.

95. Pressman, supra note 88.

96. Id.

97. Id.

98. Id. at 24. See also Liz Rappaport, Auction-Rate Case Settled by Former UBS Lawyer, WALL ST. J., Oct. 8, 2008, available at http://online.wsj.com/article/SB122339911083811849.html (stating that seven UBS executives were investigated for selling personal holdings of auction-rate securities while the firm was simultaneously aggressively marketing the securities to its clients. For example, David Aufhauser, former general counsel for UBS's investment bank, settled with New York Attorney General. The settlement included the forfeiture of one year's pay ($6 million), a $500,000 penalty and a ban from practicing law for two years.).
During the second week of February 2008, due to decreasing capital reserves and liquidity, most financial institutions stopped trying to prevent auction failures by purchasing securities for their own accounts.\(^9\) With declining financial positions, banks reached the upper limit of their risk tolerance for absorbing auction-rate securities to prevent market failure.\(^10\) For example, when the market collapsed, UBS had already increased its auction-rate securities inventory by more than $5 billion dollars in early 2008.\(^11\) The failures unraveled confidence in the market, and almost instantly, the majority of the hundreds of daily auctions failed.\(^12\) While only thirteen auctions failed between 1984 and 2006 and only thirty-one failed during the second half of 2007, eighty-seven percent of the nearly 400 daily auctions failed on February 14, 2008.\(^13\) In effect, the market for auction-rate securities disappeared overnight.\(^14\) Investors who believed that they were holding liquid cash-equivalent securities suddenly found themselves holding illiquid, long-term securities with few appealing redemption options.

IV. PREVIOUS SEC INVESTIGATIONS

The practices of financial institutions involving the auction-rate securities market has previously come under SEC scrutiny.\(^16\) However, these investigations by the SEC provide little guidance regarding marketing auction-rate securities, meaning financial institutions may be able to argue that the SEC's lack of action

99. Norwood, supra note 20 ("As the credit markets tightened, the demand for ARS and other variable rate securities began to show signs of decline and the number of failed auctions increased...The issues in the auction rate securities market are unprecedented and unexpected and flow from overall issues in the financial markets.").

100. See Melvin & Duffield, supra note 3 ("Having already suffered billions of dollars in losses resulting from the subprime mortgage collapse, the investment firms abruptly ceased their bailout practices.").


103. Id.

104. Cherdack et al., supra note 3; see Lee, supra note 3.

105. Id.

106. Infra notes 108-109 (discussing the 1995 settlement with Lehman Brothers) and note 107 (discussing the 2006 settlement with 15 financial institutions).
estops the agency from engaging in enforcement actions now.\(^\text{107}\)

The first of two principal cases in which the SEC scrutinized the auction-rate securities market occurred in 1995, when Lehman Brothers was charged and ultimately fined $850,000 by the SEC for illegally manipulating auctions that it managed on behalf of American Express.\(^\text{108}\) Second, during 2006, the SEC settled a multi-year investigation into the practices of fifteen financial institutions who were marketing auction-rate securities and managing the “Dutch” auction process.\(^\text{109}\) During the investigation that led to the joint-2006 settlement, the SEC discovered, among other findings, that broker-dealers had misled investors regarding both the liquidity and risk associated with investing in auction-rate securities and their own role in maintaining liquidity in the market by preventing auction failure.\(^\text{110}\) The SEC ruled that these actions constituted violations of the Security Exchange Act of 1934.\(^\text{111}\) The settlement had both financial and non-financial components.\(^\text{112}\)

First, the collective settlement amount for the fifteen sanctioned financial institutions was $13.375 million.\(^\text{113}\) Secondly, the SEC issued an order requiring that financial institutions provide all customers and broker-dealers with a “written description of the firms’ material auction practices and procedures.”\(^\text{114}\)

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\(^{107}\) See Lee, supra note 3.

\(^{108}\) Cherdack et al., supra note 3.

\(^{109}\) Lee, supra note 3. As part of the $13.375 million settlement, the SEC identified nine common practices among issuing financial institutions that constituted manipulation of the auction process: (1) “completion of open or market bids”; (2) “bids to set a ‘market rate’”; (3) “bids to prevent all-hold auctions”; (4) “prioritization of bids”; (5) “submission or revision of bids after deadlines”; (6) “allocation of securities” to certain investors rather than by the prescribed pro rata formula that is to be used when there are too many bids at the clearing rate”; (7) allowing bids to be revoked; (8) “express or tacit understandings to provide higher returns” by “delaying the settlement date for certain investors”; and (9) “providing different price talk to different investors.” Id.

\(^{110}\) See id.


\(^{112}\) Id.

\(^{113}\) Id.

Potentially more important to financial institutions in the current crisis, however, are two things that the SEC order did not include. First, the 2006 settlement did not include a written or financial sanction for selling auction-rate securities as "cash equivalents" despite the fact that the "Big Four" accounting firms had interpreted the Statement of Financial Accounting Standards 95 not to include auction-rate securities as "cash" or "cash equivalents" and instructed their clients, including the respective banks, to change their practices during 2004 and 2005. Second, the official release did not require firms to disclose to clients either their involvement in preventing auction failures or that the banks could cease intervention at any time, likely causing higher rates of auction failure. Finally, it should be noted that critics have argued that relative to the size and profits of the issuing banks, fines, ranging from $125,000 to $1.5 million per institution, were likely too small to make a meaningful impact on future behavior.

V. POST-MARKET FAILURE

Unlike other types of securities, the collapse of the auction-rate securities market did not decrease the value of those securities. It is critical to remember that auction failures are not equivalent to defaults. The securities have simply become illiquid as a result of a supply and demand imbalance.

Thomsen, Director, Division of Enforcement, U.S. Securities and Exchange Commission).

115. Price Waterhouse Coopers, Deloitte Touche Tohmatsu, Ernst & Young, and KPMG.
116. Cherdack et al., supra note 3.
118. Cherdack et al., supra note 3.
119. Fazio et al., supra note 21.
120. Norwood, supra note 20.
121. Id.; Fazio et al., supra note 21.
Following the collapse of the auction-rate securities market, investors holding auction-rate securities initially faced two unappealing alternatives from litigation. First, investors could continue to hold the securities and accept the “penalty” interest rate while hoping and waiting for restoration of liquidity to the market or a government-driven solution that would provide liquidity. The “penalty” interest rate that investors receive in the meantime varies widely depending on the type of issuer. Municipality-issued auction-rate securities, which represented fifty percent of the auction-rate securities market at the end of 2007, have substantially higher “penalty” interest rates than those issued by other types of issuers, such as closed-end mutual funds. Because of the generally high “penalty” rates for municipal issuers, some municipalities faced a sudden increase in their cost of capital.

Investors also had the option to attempt to sell the securities in a secondary market, often at a substantial discount. The creation of secondary markets shortly after the February collapse has allowed some investors to liquidate their investments. Restricted Securities Trading Network has been the most prominent secondary market since March 2008. Unfortunately, investors seeking to redeem their auction-rate securities holdings in secondary markets have had to accept substantial discounts. Discounts have averaged up to ten percent for municipal auction-rate securities, ten to twenty percent for mutual fund-backed securities, and more than twenty-five percent for student loan auction-rate securities.

122. Supra notes 65-74 and accompanying text.
123. Supra notes 65-74 and accompanying text.
124. Supra notes 65-74 and accompanying text.
125. Melvin & Duffield, supra note 3 (explaining that 50% of the auction-rate securities market was composed of municipal issuers); Norwood, supra note 20.
126. Cherdack et al., supra note 3.
127. Id.
128. Id.
129. Id.
A. Alternative Action to Restore Liquidity

The SEC has taken a leading role in trying to address the collapse of the auction-rate securities market. While simultaneously working alongside state Attorneys General to investigate banks’ conduct, the SEC and the Internal Revenue Service [hereinafter IRS] have worked with bankers to review potential rule changes and other alternative solutions that could restore liquidity to the market. Municipal issuers facing substantially higher interest rate payments due to the higher “penalty” rates are anxious to restructure outstanding auction-rate securities issues, increasing pressure on the SEC.

Immediately following the February collapse, the Securities Industry and Financial Markets Association pushed the Treasury Department to make rule changes to smooth the path for debt restructuring. In March 2008, the IRS issued two rule changes to ease the restructuring process for municipal auction-rate securities. IRS Notice 2008-27 specifically stated that conversions of auction-rate securities to bonds would not constitute a reissuance for tax purposes, thereby decreasing the disadvantageous tax consequences associated with such a transaction. This has allowed some municipalities to provide liquidity to investors through conversions to fixed-rate bonds or variable-rate demand notes. Such investment products have provisions requiring either a third-party agent or the issuer to purchase the bonds at par at any time, thus providing investors the ability to redeem their investments at will. IRS Notice 2008-41 temporarily waived the prohibition against municipalities purchasing their own auction-rate securities. The waiver, which has now been extended indefinitely, permits municipalities to hold

130. See SEC’s Recent Auctions, supra note 114.
131. Id.; Norwood, supra note 20; see Humphreys, supra note 35.
132. Lee, supra note 3.
133. Norwood, supra note 20; see Fazio et. al., supra note 21.
134. Norwood, supra note 20; see Humphreys, supra note 35.
137. Id.
138. Id.
their own auction-rate securities for up to 180 days. The SEC supported the IRS's initiative by issuing a "no-action" letter stating that it would allow issuers with the necessary capital to bid on their own securities. Some were concerned because the SEC had frowned on such purchases during the 2006 joint settlement with auction-rate securities brokers regarding their practices. Specifically, broker-dealers were concerned that such purchases would be "construed by the SEC to constitute market manipulation or that a broker-dealer's participation in an auction on behalf of an issuer would violate any consent order it may have with the SEC." This provision has allowed some liquidity to be restored to the market by allowing auctions to clear again.

The SEC has also evaluated requests from closed-end fund-backed issuers of auction-rate securities to waive some provisions of the Investment Company Act of 1940. In an attempt to pacify angry auction-rate securities holders, closed-end funds have looked into redeeming illiquid auction-rate securities by raising capital through the issuance of debt securities or new classes of preferred shares. Two concerns have arisen. First, proposals for closed-end funds to provide liquidity to investors by redeeming their auction-rate shares that are classified as preferred stock have been challenged as violating the fund's fiduciary duty to their common share holders. This duty to common stockholders is codified in the 1940 Investment Company Act. In an April 2008 letter to SEC Chairman Christopher Cox, several members of the House of Representatives asked the SEC to provide a view on

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139. IRS Notice 2008-41; see also IRS Notice 2008-88 (extending indefinitely and amending 2008-41).
140. Norwood, supra note 20, at 11.
141. Id.
142. Id.
143. Norwood, supra note 20.
144. Humphreys, supra note 35; see Lawmakers Seek Input From SEC, supra note 73.
145. Humphreys, supra note 35.
146. See Lawmakers Seek Input From SEC, supra note 73; Humphreys, supra note 35.
147. Lawmakers Seek Input From SEC, supra note 73; Humphreys, supra note 35.
whether the fiduciary duty to common stock holders would in fact be breached by redemption of preferred stock shares.\(^{149}\)

Secondly, the Investment Company Act of 1940 regulates the issuing of debt or preferred shares by closed-end funds by requiring that a fund maintain a post-issuance asset-coverage ratio of 200 percent for preferred securities and 300 percent for debt securities.\(^{150}\) In order to raise money to redeem auction-rate securities, several funds have sought a waiver from the SEC to issue preferred shares or debt without complying with the asset-coverage ratio requirements in order to raise money to redeem auction-rate securities.\(^{151}\) At least one, Eaton Vance Management, was provided such a waiver to issue preferred securities.\(^{152}\) In effect, this waiver served as a green light for other closed-end funds to make plans to request such a waiver and plan to issue new classes of preferred shares or other debt securities.\(^{153}\)

Broker-dealers have also faced challenges when trying to redeem their clients' auction-rate securities holdings.\(^{154}\) Firms are facing capital limitations due to the financial crisis and thus have limited funding available for voluntary matters such as the purchasing of illiquid securities from their clients.\(^{155}\) Furthermore, broker-dealers are constrained by the Federal Reserve's Regulation W.\(^{156}\) Regulation W limits the amount of credit a financial institution can lend to a client if it owns securities issued by that client in its own portfolio.\(^{157}\)

**VI. INVESTIGATIONS & LITIGATION**

Three types of suits have been filed against issuing banks and their employees related to the auction-rate securities market collapse. First, criminal investigations have been launched and, in

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149. *Lawmakers Seek Input From SEC*, supra note 73.
151. *Humphreys*, supra note 35.
152. *Id.*
153. *Id.*
155. *Id.*
156. *Id.*
157. *Id.*
at least one case, charges have been filed by both the Department of Justice and the SEC against individual brokers and banking executives, as well as financial institutions.\textsuperscript{158} Second, state Attorneys General, the SEC, and other groups have commenced civil investigations into the marketing practices of financial institutions selling auction-rate securities.\textsuperscript{159} Such investigations have resulted in civil suits against both issuing banks as well their employees.\textsuperscript{160} Finally, individual investors holding illiquid auction-rate securities have also filed suits.\textsuperscript{161}

\textbf{A. Criminal Investigations & Suits}

Criminal investigations have been launched in cases where brokers appear to have committed egregious fraud.\textsuperscript{162} In one such case, filed on September 6, 2008, two Credit Suisse brokers allegedly misrepresented the issuer of auction-rate securities and in some cases told clients that the auction-rate securities they were purchasing were an entirely different investment.\textsuperscript{163} The SEC's complaint states that the brokers purchased more than $1 billion of auction-rate securities backed by mortgages when their clients had only given them permission to purchase less risky student-loan-backed auction-rate securities.\textsuperscript{164} Due to the increased risk, the brokers were incentivized to sell auction-rate securities because they commanded substantially higher broker fees due to

\begin{itemize}
\item \textsuperscript{159} Melvin & Duffield, \textit{supra} note 3.
\item \textsuperscript{160} Id. (stating that several states which are members of North American Securities Administrators Association (NASAA) have created a joint task force to investigate the collapse of the auction-rate securities market).
\item \textsuperscript{161} Infra notes 238-253 and accompanying text.
\item \textsuperscript{162} See, e.g., Tzolov at 1-2, 08 Civ. 7699 (S.D.N.Y 2008); Charges Over ARS Sale, \textit{supra} note 158.
\item \textsuperscript{163} Tzolov at 4-15, 08 Civ. 7699 (S.D.N.Y 2008); Charges Over ARS Sale, \textit{supra} note 158.
\item \textsuperscript{164} Tzolov at 4, 08 Civ. 7699 (S.D.N.Y 2008).
\end{itemize}
the securities' increased risk. The complaint also alleges that the brokers sent, or instructed associates to send, e-mails that confirmed purchases of student-loan-backed auction-rate securities. On account of the failure of the auction-rate securities auctions for risky mortgage-backed securities in August 2007, the clients were left with more than $817 million in such securities that they had never authorized their brokers to purchase.

The Department of Justice also launched two criminal investigations as of early January 2009: (1) whether Lehman Brothers defrauded its clients and; (2) whether David Schulman, a former UBS executive, was involved in auction-rate securities-related insider trading. Specifically, prosecutors are gathering evidence regarding whether Lehman Brothers brokers put auction-rate securities into the account of a client, the Maher brothers, despite concern of a market failure. As a result of the auction-rate securities market collapse, the Maher brothers lost access to $286 million. Prosecutors investigated whether brokers used the brothers' money to buy auction-rate securities to prevent auction failure.

B. Civil Liability Overview

This note focuses on two aspects of financial institutions' potential liability relating to selling and marketing auction-rate securities prior to the collapse of the market: (1) the marketing of auction-rate securities as liquid, cash-equivalent investments; and (2) the non-disclosure of intervention by banks to prevent market failure or the failure to disclose that the banks were not obligated to continue to do so. The many adversaries of issuing financial

165. Id. at 4-7.
166. Id. at 4-5.
167. Id. at 2.
168. Investigation Picks Up Steam, supra note 158; see also, supra notes 88-94 and accompanying text (discussing David Schulman's contradictory interactions with UBS's risk management department and its brokers).
169. Investigation Picks Up Steam, supra note 158.
170. Id.
171. Id.
172. See infra notes 175-178 and accompanying text.
institutions believe that these actions amount to misrepresentation and/or deception and thus civil liability for fraud. Allegations also include charges by investors that the aforementioned activity was illegal under federal law, notably the Securities Exchange Act.

The most common allegation against issuing financial institutions is that brokers marketed and sold the securities to investors as liquid, cash-equivalent investments that were virtually identical to money market funds. Furthermore, claimants allege that market support to prevent auction failure was either expressly guaranteed or implied by brokers. Survey results show that nearly seventy percent of investors believed that “auction support” was “implied” by dealers. Seventeen percent said they were “explicitly” told that the “bank would ensure that auctions did not fail.”

C. Federal & State Investigations & Suits

The SEC and FINRA as well as several state Attorneys General launched investigations into the practices of financial institutions regarding auction-rate securities during the months following the collapse of the auction-rate securities market. With the exception of New York, notable state action occurred in conjunction with the North American Securities Administrators Association [hereinafter NASAA]. Nine states that are members of the association formed the ARS Taskforce to coordinate their investigations. By late July, New York Attorney General Andrew Cuomo had filed a lawsuit against one

174. Melvin & Duffield, supra note 3.
175. Id.
176. Id.
178. Id.
179. Melvin & Duffield, supra note 3.
180. Id.
181. Id. Florida, Georgia, Illinois, Massachusetts, Missouri, New Hampshire, New Jersey, Texas, and Washington. Id.
182. Id.
of the largest auction-rate securities players, UBS, accusing the firm of falsely marketing the securities.\footnote{Somers, supra note 93.}

While much attention focused on investigations, suits, and settlements involving the world's largest financial institutions, the actions of smaller brokers and consequences for their clients have caught the attention of FINRA.\footnote{Breakdown of Auction Rate Securities Markets: Auction Rate Securities Market: Hearing Before the H. Comm. On Fin. Serv., 110th Cong. (2008) (statement of Susan Merrill, Executive Vice President and Chief of Enforcement, Financial Industry Regulatory Authority) [hereinafter Merrill].} Whereas the SEC was primarily focused on select large firms, FINRA aimed to "protect[] additional investors and restore[] funds to a broader span of customers."\footnote{Id.}

Investigators are concentrating in part on whether brokers' actions violated one of two sections of the Securities Exchange Act of 1934.\footnote{Melvin & Duffield, supra note 3.} The Securities Exchange Act of 1934 prohibits illegal deception and manipulation by securities brokers.\footnote{See Securities Exchange Act of 1934 § 10, 15 U.S.C.A. § 78 (2006).} Section 10(b) of the Act makes it illegal to use "any manipulative or deceptive device or contrivance in contravention" of the rules issued by the SEC "for the protection of investors."\footnote{15 U.S.C.A. § 78(j)(b) (2006).} Moreover, Section 20(a) of the Act establishes joint and several liability for all those participating in illegal actions under the Act.\footnote{15 U.S.C.A. § 78(t)(a) (2006).} One of the questions that courts would have to answer if such a case is litigated is whether or not the broker's actions rose to the level of a "manipulative" or "deceptive" device that would be in violation of the Securities Exchange Act.\footnote{See Consol. Amended Complaint, In re Citigroup Auction Rate Securities Litigation, 08 Civ. 3095 (LTS)(FM), (S.D.N.Y. Aug. 8, 2008).}

The strength of the claims that issuing financial institutions acted fraudulently and/or violated the Securities Exchange Act of 1934 depends on several factors: what the broker communicated to the client, how such investments were noted on account statements, and what written materials describing the investments were provided to investors to assess the validity of the statutory
violations. The strength of each claim will also depend on the type of investor, as institutional investors are generally expected to be savvier, and whether the investor can establish tangible adverse consequences due to the lack of liquidity in the auction-rate securities market.

D. Settlements

The civil investigations and suits filed by the SEC, state Attorneys General, and other organizations have resulted in sizable settlements that will restore liquidity to many auction-rate securities holders. However, the settlements only cover a portion of the $330 billion of illiquid assets. For example, as of September 18, 2008, sixty-two percent of the originally-outstanding $166 billion of municipal auction-rate securities had been refinanced or plans had been made for refinancing and forty percent of the original $64 billion of closed-end fund auction-rate securities had been redeemed or plans had been made to redeem them. However, by the end of 2008, nearly $200 billion of the $330 billion market had been recovered, leaving $135 billion frozen.

Citigroup's August 7, 2008, joint settlement with both state Attorneys General and the SEC commenced a period of hasty settlements by the world's largest financial institutions. During the subsequent two months, Bank of America, UBS, Morgan

191. Fazio et al., supra note 21.
192. Id.
193. Id.
194. Thomsen, supra note 114.
195. Id.
Stanley, Merrill Lynch, J.P. Morgan, and Wachovia each settled with at least one governmental body or FINRA. The SEC was directly involved in the Bank of America, Citigroup, UBS, Wachovia, and Merrill Lynch settlements. The settlements represent the largest return of money to investors in the SEC’s history. There are six common features of these large settlements.

First, the principal feature of each settlement is a repurchase of auction-rate securities by the issuing bank. These buybacks have been restricted to retail investors and in some cases also charitable organizations and small to mid-sized business. In most cases, the sizes of the buybacks have been limited for each client. For example, both J.P. Morgan and Bank of America have agreed to only buy back up to $10 million worth of auction-


199. See Bray & Barris, supra note 198 (discussing Bank of America’s settlement with the SEC); Herzfeld & Joyce, supra note 93 (discussing Wachovia’s settlement with the SEC); Citigroup Agrees With SEC, supra note 197 (discussing Citigroup’s settlement with the SEC); Preliminary Settlement With Merrill, supra note 198 (discussing Merrill Lynch’s settlement with the SEC); Melvin & Duffield, supra note 3 (discussing the SEC’s involvement); Vetter, supra note 197 (discussing the SEC’s involvement in obtaining settlements for investors in auction-rate securities).


201. See infra notes 202-237 and accompanying text.

202. Id.

203. Id.

204. Id.
rate securities from each client.\textsuperscript{205} Bank of America made an exception for charitable organizations from whom the bank agreed to repurchase up to $25 million worth of auction-rate securities.\textsuperscript{206} As of the end of 2008, Bank of America had repurchased ninety-three percent of the $4.5 billion worth of auction-rate securities held by retail investors while $5 billion of auction-rate securities held by institutional investors, those with holdings in excess of $10 million, was still illiquid.\textsuperscript{207} Despite the limitations, the buybacks represent a sizable portion of banks’ outstanding auction-rate securities issues.\textsuperscript{208} For example, the direct buyback will affect holders of more than $7 billion of the $20 billion worth of auction-rate securities that Citigroup had issued.\textsuperscript{209} UBS’s large $19 billion settlement stands as a notable exception as it is the only settlement that includes an agreement to buy back securities from all investors who purchased securities from UBS within the designated period.\textsuperscript{210} Usually, the deadlines for buybacks were set within three to six months of the settlement dates, which ranged from August to October 2008.\textsuperscript{211} Nevertheless, several settlements also included a provision for the banks to provide no-interest loans to clients to provide them the necessary liquidity as the banks work through the process of repurchasing the securities.\textsuperscript{212} Furthermore, FINRA also formally reminded financial institutions to adopt procedures to ensure that customers are treated fairly and impartially.\textsuperscript{213} Unfortunately, the settlements have left even some retail investors without recourse.\textsuperscript{214} For example, a Massachusetts law professor, Irene Scharf, had invested $75,000 in auction-rate

\textsuperscript{206} Breitman, \textit{supra} note 198.
\textsuperscript{207} Healy, \textit{supra} note 196.
\textsuperscript{208} \textit{Citigroup Agrees With SEC, supra} note 197; Vetter, \textit{supra} note 197; \textit{see supra} notes 204-207 and accompanying text.
\textsuperscript{209} \textit{Citigroup Agrees With SEC, supra} note 197 (discussing Citigroup’s settlement with the SEC).
\textsuperscript{210} Healy, \textit{supra} note 196; \textit{Come In From The Cold, supra} note 1.
\textsuperscript{211} Melvin & Duffield, \textit{supra} note 3.
\textsuperscript{212} \textit{See Melvin & Duffield, supra} note 3; Vetter, \textit{supra} note 197.
\textsuperscript{213} Merrill, \textit{supra} note 184.
\textsuperscript{214} \textit{Come In From The Cold, supra} note 1.
securities in 2005 to pay for her son's college tuition on the advice of her UBS broker. In 2007, that broker moved to SmithBarney and Scharf moved her account to SmithBarney. The settlement reached with UBS, however, only cover investors who still held their securities at UBS whereas the settlement reached with SmithBarney only applied to those who purchased the securities through SmithBarney, thus leaving Scharf holding illiquid securities with no reasonable redemption option available.

Second, while protections for institutional investors are not as strong, settlements have usually included either a good-faith promise for each bank to use its best efforts to liquidate auction-rate securities held by institutional investors or a longer-term deadline to liquidate the holdings of institutional investors. Both J.P. Morgan and Citigroup, for example, agreed to “use (their) best efforts” to provide liquidity for institutional holders of auction-rate securities and set a “goal” of addressing all liquidity issues by the end of 2009. UBS, on the other hand, set a finite goal of liquidating all institutional auction-rate securities holdings by the end of 2009. The dichotomy in banks’ willingness to include retail and other small investors in settlements while not including institutional investors may be attributed to both the impactful effect that retail investors would have “on the stand” should the investors proceed with litigation and also because institutional investors are naturally expected to have more sophisticated knowledge of investment products.

Third, auction-rate securities holders who sold their securities at a loss in the secondary market after the collapse of the auction-rate securities market in early February 2008 will be able to recover the losses that they incurred by selling at a discount to achieve the liquidity as they had expected. In other words,

215. Id.
216. Id.
217. Id.
218. Citigroup Agrees With SEC, supra note 197; Preliminary Settlement With Merrill, supra note 198; Melvin & Duffield, supra note 3; Vetter, supra note 197.
219. Press Release, JPMorgan Chase, supra note 205; Citigroup Agrees With SEC, supra note 197.
220. Melvin & Duffield, supra note 3.
221. Lockman, supra note 10, at 10.
222. Bray & Barris, supra note 198; Press Release, JPMorgan Chase, supra note
investors will receive compensation for the difference between the price at which they sold their auction-rate securities in the secondary market and the par value of their securities.\textsuperscript{223}

Fourth, several banks have agreed to reimburse refinancing fees for certain issuers who recently refinanced their auction-rate securities, issued on or after August 1, 2007.\textsuperscript{224} The relief is somewhat limited, however.\textsuperscript{225} J.P. Morgan and Bank of America, for example, agreed to such a provision only for municipal issuers of auction-rate securities.\textsuperscript{226}

Fifth, several settlements have provided for use of a special arbitration process specifically for auction-rate securities claims to award consequential damages to investors for harm associated with the unexpected illiquidity of their investments.\textsuperscript{227} The arbitration process will be run by FINRA, which is the largest private regulator of securities firms.\textsuperscript{228}

While banks have generally been unwilling to publicly accept liability publicly or in the settlement agreements, the FINRA arbitration process will not allow the banks to dispute liability.\textsuperscript{229} Banks will only be able to challenge the claims for consequential damages on their merits.\textsuperscript{230} Cases in which the damages claimed are less than $50,000 will be heard by a public arbitrator, whereas cases in which the damages claimed are greater than $50,000 will be heard by two public arbitrators and one non-public arbitrator.\textsuperscript{231} A new special arbitration proceeding for claims greater than $1 million may be heard, by agreement, by a panel of three public arbitrators.\textsuperscript{232} Conflict of interest checks will

\begin{footnotesize}
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\item \textsuperscript{205} Herzfeld, supra note 198; Melvin & Duffield, supra note 3.
\item \textsuperscript{223} Melvin & Duffield, supra note 3; Vetter, supra note 197.
\item \textsuperscript{224} Melvin & Duffield, supra note 3; Vetter, supra note 197.
\item \textsuperscript{225} Melvin & Duffield, supra note 3; Vetter, supra note 197.
\item \textsuperscript{226} Bray & Barris, supra note 198; Press Release, JPMorgan Chase, supra note 205.
\item \textsuperscript{227} Melvin & Duffield, supra note 3; Vetter, supra note 197.
\item \textsuperscript{228} Merrill, supra note 184; Melvin & Duffield, supra note 3; Vetter, supra note 197.
\item \textsuperscript{229} Melvin & Duffield, supra note 3; see also Citigroup Agrees With SEC, supra note 198.
\item \textsuperscript{230} See FINRA Provides Details on Special Arbitration Procedure for ARS Consequential Damages, U.S. FED. NEWS, Dec. 16, 2008, 2008 WLNR 24126091.
\item \textsuperscript{231} Id.
\item \textsuperscript{232} Id.
\end{itemize}
\end{footnotesize}
be run to ensure that no non-public arbitrator has sold auction-rate securities, worked for a firm that sold auction rate securities, or supervised someone who did. As of the end of November 2008, 275 cases had been filed to be arbitrated by FINRA.

Finally, most of the settlements have included civil penalties paid directly to the states or to NASAA, which has joined forces with several states for auction-rate securities investigations. Civil penalties in the first wave of settlements have already reached $150 million per bank, paid by UBS and split evenly between NASAA and the State of New York. In this case, like most, the SEC deferred assessing a penalty.

E. Investor Suits

Due to the large settlements aimed at providing relief for retail investors as well as the frequent use of arbitration, there have been relatively few suits filed by individuals against issuing financial institutions. As of mid-December 2008, twenty class action suits related to the collapse of the auction-rate securities market had been filed during 2008. A small number of suits filed independently by investors were also filed during 2008. Nevertheless, it is anticipated that government investigations and resulting settlements will encourage other investors to file their own suits. Furthermore, given most of the settlements’ targeted scope of coverage, the holders of a large portion of illiquid auction-rate securities remain without a clear avenue for relief. Specifically, institutional investors and those holding auction-rate

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233. Id.
234. Id.
235. Supra note 218.
236. Melvin & Duffield, supra note 3.
237. Id.
238. See Suit Against UBS, supra note 14.
240. See Girard, supra note 14.
241. Melvin & Duffield, supra note 3.
securities sold by "downstream" brokers generally lack an option to restore liquidity to their investments.\textsuperscript{243}

Nevertheless, some investors have achieved preliminary success in their suits against issuing banks.\textsuperscript{244} One institutional investor, New York-based Plug Power Inc., which invested $62.9 million in student-loan-backed auction-rate securities, achieved preliminary success in pursuing its suit against UBS for misrepresenting the safety of auction-rate securities.\textsuperscript{245} On September 17, 2008, a federal judge dismissed UBS's motion to dismiss the case.\textsuperscript{246} The bellwether suit was watched closely by other institutional investors, many of whom are considering litigation as a means of restoring liquidity to their auction-rate securities.\textsuperscript{247} As previously noted, institutional investors' interest in litigation stems in part from the insufficiency of settlements reached by the SEC, FINRA, and state Attorneys General.\textsuperscript{248} George Capinello of Boies, Schiller, & Flexner, who represented Plug Power Inc., said: "We need the funds before 2010, and they're not providing us a [guarantee] that they will be able to pay us in 2010."\textsuperscript{249} The suit alleged that UBS violated Plug Power's instructions not to invest in auction-rate securities that were subject to interest-rate caps and that UBS misrepresented auction-rate securities as "'highly liquid and safe and that they were virtually the equivalent to money market investments or cash.'")\textsuperscript{250} Plug Power Inc. and UBS reached a settlement on December 15, 2008, that included an agreement that UBS repurchase the entirety of the company's auction-rate securities holdings between 2010 and 2012 and provide a no-interest loan equivalent to the value of the securities in the meantime.\textsuperscript{251} The suit was "dismissed with

\textsuperscript{243} Id.
\textsuperscript{244} See, e.g., Suit Against UBS, supra note 14.
\textsuperscript{245} Id.
\textsuperscript{246} Id.
\textsuperscript{247} Id.
\textsuperscript{248} Id.; supra notes 193-237 and accompanying text.
\textsuperscript{249} Id. Suit Against UBS, supra note 14.
\textsuperscript{251} Id.
prejudice." Class actions representing individual "retail" investors have also been filed.

VII. CONCLUSION

Given the size of the auction-rate securities market, the litigation fallout from the market's collapse will likely continue for the foreseeable future. Whether issuing institutions with regulatory agency support can help restore liquidity to the market via alternative solutions will likely influence the volume of litigation and the cost of settlements during the next year. The turmoil in the financial markets and global recession may render restoring liquidity to the market a low priority for regulators and banks.

SEAN T. SEELINGER

252. Id.