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**THE PEOPLE OF THE STATE OF CALIFORNIA**  
**BY AND THROUGH THE COMMISSIONER OF CORPORATIONS**

In the matter of	)	
	)	
<b>E*TRADE SECURITIES LLC</b>	)	<b>FINDINGS OF FACT</b>
	)	<b>CONCLUSIONS OF LAW</b>
	)	<b>CONSENT ORDER</b>
	)	
Respondent.	)	
	)	
_____	)	

WHEREAS, E\*TRADE Securities LLC (“Respondent”) is a broker-dealer registered in the state of California and

WHEREAS, Respondent’s activities regarding the sale of auction rate securities (“ARS”) have been the subject of coordinated investigations conducted by a multi-state task force; and

WHEREAS, Respondent has provided documentary evidence and other materials and provided regulators with access to information relevant to their investigations; and

WHEREAS, on October 18, 2011 Respondent and the multi-state task force reached an agreement to resolve the investigations relating to Respondent’s sale of auction rate securities to certain customers; and

WHEREAS, Respondent agrees, among other things, to purchase certain auction rate securities from customers and to make certain payments; and

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

WHEREAS, Respondent admits the jurisdiction of California Corporations Commissioner (“Administrator”) and consents to the entry of this Order by Administrator; and





1 maximum rate becomes the rate of interest the ARS earns until the next successful auction, at which  
2 time the rate is reset during the bidding process.

3 14. As is generally the case in the capital markets, issuers and investors are connected via  
4 intermediaries or financial institutions that serve in various capacities in the ARS marketplace. The  
5 major roles of intermediaries in the ARS market are: (1) large broker-dealers who act as ARS  
6 underwriters and often also serve as auction dealers, (2) auction agents selected by the underwriters  
7 to collect orders and match buyers with sellers, (3) major broker-dealers who trade in ARS and act as  
8 wholesalers, and (4) downstream broker-dealers who place retail customer orders through the  
9 wholesalers trading in ARS.

10 15. Respondent did not perform any of the major intermediary functions identified as (1)  
11 through (3) above. Rather, from 2003 to February 2008, it acted as a downstream broker-dealer that  
12 relayed retail customer orders to Oppenheimer & Co., which was a wholesaler trading in Auction  
13 Rate Preferred Securities ("ARPS"). Oppenheimer then transmitted Respondent's customer orders to  
14 auction dealers to complete the purchase or sale.

#### 15 ARPS

16 16. Of the types of ARS that were available from 2003 through February 2008,  
17 Respondent generally sold ARPS to its customers. ARPS are preferred stock issued by closed-end  
18 mutual funds. Because ARPS are preferred shares, they have no maturity date and there is no  
19 obligation upon the issuer to redeem shares on demand. Therefore, their period of existence is "in  
20 perpetuity."

21 17. Prior to February 2008 when the market for ARS (including ARPS) collapsed, ARPS  
22 were generally perceived to be a relatively safe and liquid fixed income investment. The primary  
23 benefit was a higher rate of interest than could typically be achieved by investing in Treasury bills or  
24 money market accounts. As a general rule, ARPS could be expected to pay a rate of at least 50 basis  
25 points, or one-half percent interest, in excess of what a money market account was paying at the same  
26 time.





1 shares if it is economically advantageous to do so, but there is no obligation upon issuers to do so.  
2 Alternatively, an ARS holder may be able to arrange a sale on an ad hoc basis outside the auction  
3 process. However, such sales are on a case by case basis and often involve discounts to the par value  
4 of the ARS, resulting in a financial loss to the holder.

5 30. Consequently, the liquidity of ARS (including ARPS) depended upon the continued  
6 success of the Dutch auction process.

### 7 **Collapse of the Dutch Auction Process**

8 31. The Dutch auction process functioned with very few auction failures for many years  
9 after the introduction of ARS in 1984. Over the years, there had been approximately 13 auction  
10 failures, typically arising when an issuer lost its creditworthiness, thus eliminating buyer interest in  
11 that security. However, prior to February 2008, there had not been an ARPS auction failure nor had  
12 there been a total collapse of the ARS auction market.

13 32. Beginning in August 2007, deteriorating economic conditions and tightening credit  
14 markets caused a strain on the ARS market, resulting in a number of ARS auction failures. However,  
15 prior to February 2008, these failures did not involve the ARPS auction markets because ARPS were  
16 generally considered safer and more creditworthy investments.

17 33. However, in February 2008, an event occurred that caused the wholesale collapse of  
18 the ARS auction market, including ARPS. The triggering event was the decision by a major  
19 underwriter, Goldman-Sachs, to stop submitting cover bids. Large underwriters, like Goldman-Sachs,  
20 found that due to deteriorating financial conditions, they could no longer afford to carry large  
21 balances of ARS on their books and thus they stopped buying ARS for their own accounts. Once  
22 Goldman-Sachs stopped submitting cover bids at auction, all the other large underwriters followed  
23 suit.

24 34. Without the support of the large underwriters, insufficient buy bids were received at  
25 most auctions to cover all the ARS offered for sale, and as a result the auction market totally  
26 collapsed. The ARPS auction market was particularly hard hit because the maximum, or default, rates  
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1 for ARPS were generally very low and therefore there was insufficient investor interest to sustain the  
2 market in the absence of the underwriter's cover bids.

3 35. As of February 13, 2008, Respondent's investors nationwide held a balance of  
4 approximately \$581 million in ARPS, and approximately \$870 million altogether in the ARS market,  
5 that had lost liquidity as the result of the collapse of the auction process.

6 **Failure to Supervise**

7 36. Respondent had a policy of hiring experienced FAs who, presumably, had been  
8 trained by other employers with regard to the securities they handled. However, Respondent  
9 provided no formal training to its FAs with respect to ARPS.

10 37. Respondent's FAs were directly supervised by a branch manager whose supervisory  
11 responsibilities were set out in Branch Policies and Procedures manuals. In addition, FAs were  
12 provided with a Registered Representatives Manual that governed their professional practice. None  
13 of these documents specifically addressed the need for FAs to advise ARPS customers of the risks of  
14 auction failure and loss of liquidity. Respondent maintained a policy of reviewing FA-investor phone  
15 conversations and account records on a random basis and providing feedback. Despite these  
16 supervisory reviews, FAs continued to advise ARPS investors that ARPS were highly liquid "7-day  
17 paper," without the additional context that ARPS were in fact long term instruments that could only  
18 be liquidated at successful Dutch-style auctions.

19 38. Even when the significant risk of auction failure with regard to other types of ARS  
20 became apparent, FAs were not instructed to provide any warning about the risk of ARPS illiquidity.

21 39. Respondent should have known that its FAs marketed ARS to customers as highly  
22 liquid and as an alternative to cash or money market funds without adequately disclosing that ARS  
23 are complex securities that may become illiquid.

24 40. In connection with the marketing of ARS, Respondent failed to adopt policies and  
25 procedures reasonably designed to ensure that its FAs recommended ARS only to customers who had  
26 stated investment objectives that were consistent with their purchase of ARS. Some of Respondent's  
27 FAs recommended ARS to customers as a liquid, short-term investment. As a result, some of  
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1 Respondent’s customers who needed short-term access to funds invested in ARS even though ARS  
2 had long-term or no maturity dates.

3 **III.**

4 **CONCLUSIONS OF LAW**

5 41. The Administrator has jurisdiction over this matter pursuant to California Corporate.  
6 Securities Laws and because Respondent is and, at all times relevant to this order, was registered in  
7 California as a broker-dealer

8 42. By engaging in the acts and conduct set forth in paragraphs II.2 through II.40,  
9 Respondent failed to reasonably supervise its financial advisors in connection with the marketing of  
10 ARS to its customers, in violation of Title 10, Ch. 3, section 260.218.4(a) of the California Code of  
11 Regulations.

12 **IV.**

13 **ORDER**

14  
15 On the basis of the Findings of Fact, Conclusions of Law, and Respondent’s consent to the  
16 entry of this Order, without admitting or denying the facts or conclusions herein,

17 **IT IS HEREBY ORDERED:**

18 1. This Order concludes the investigation by the Administrator and staff and precludes  
19 any other action that the Administrator or staff could commence against the Respondent under  
20 applicable California law on behalf of California as it relates to Respondent’s sale of auction rate  
21 securities prior to February 13, 2008.

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

24 3. Respondent shall desist and refrain from violating Title 10, Ch. 3, section 260.218.4(a)  
25 of the California Code of Regulations for failure to supervise its employees with regard to the sale of  
26 securities and will comply with Title 10, Ch. 3, section 260.218.4(a).  
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1           4.       Within 10 days from the entry of this Order, Respondent shall pay penalties and costs  
2 in the sum of One Million Ninety Five Thousand Fifteen Dollars and Twenty Once Cents  
3 (\$1,095,015.21) to The California State Corporations Fund, which amount constitutes California's  
4 proportionate share of the total state settlement amount of \$5,000,000.00. In the event another state  
5 securities regulator determines not to accept Respondent's settlement offer, the total amount of the  
6 payment to the state of California shall not be affected.

7           5.       Respondent shall take certain measures with respect to current and former customers  
8 with respect to "Eligible Auction Rate Securities", as defined below in Paragraph IV.6.

9           6.       "Eligible Auction Rate Securities." For purposes of this Order, "Eligible Auction Rate  
10 Securities" means auction rate securities that Respondent's customers purchased through Respondent,  
11 or through an entity acquired by Respondent, on or before February 13, 2008, and that have failed at  
12 auction at least once since February 13, 2008.

13          7.       "Eligible Investors". For purposes of this Order, "Eligible Investors," shall mean the  
14 following:

15           (a)       Current and former account holders who purchased Eligible Auction Rate Securities  
16 through Respondent on or before February 13, 2008, whether or not such Eligible Auction Rate  
17 Securities were transferred away from Respondent, and held those securities on February 13, 2008.

18           (b)       As for customers who purchased Eligible Auction Rate Securities from an entity  
19 acquired by Respondent, only those customers who became customers of Respondent and transferred  
20 their ARS holdings to Respondent following the acquisition shall be considered "Eligible Investors."

21          8.       Not Included In the Definition of "Eligible Investors." "Eligible Investors" for the  
22 purposes of this Order, shall not include the following:

23           (a)       Senior management of Respondent and its predecessors or Respondent's financial  
24 advisors/registered representatives.

25           (b)       Customers who, as a result of prior legal proceedings with E\*TRADE, have  
26 previously had claims adjudicated.

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1 (c) Customers who received par value for their ARS through a sale, issuer redemption, or  
2 payment from Respondent.

3 9. Purchase Offer. Respondent shall offer to purchase (or offer to arrange a third party to  
4 purchase), at par plus accrued and unpaid dividends/interest, from Eligible Investors their Eligible  
5 Auction Rate Securities that have failed at auction at least once since February 13, 2008 (the  
6 “Purchase Offer”).

7 10. Notification and Buyback Procedures.

8 a. Respondent shall create a written notice related to the Purchase Offer (the “Notice”).  
9 The Notice shall explain the relevant terms of this Order and describe what Eligible Investors must  
10 do to accept, in whole or in part, the Purchase Offer, including how Eligible Investors may accept the  
11 Purchase Offer.

12 b. Initial Notice

13 i. Respondent shall provide the Notice to Eligible Investors who purchased  
14 Eligible Auction Rate Securities with Respondent by January 16, 2012.

15 ii. Furthermore, by January 16, 2012, Respondent shall undertake its best efforts  
16 to identify and locate customers who purchased Eligible Auction Rate Securities with Respondent but  
17 who transferred such Eligible Auction Rate Securities away from Respondent between February 13,  
18 2008 and November 16, 2011. Respondent will provide any such customers the Purchase Offer  
19 described in Section IV.9, the Notification and Buyback Procedures described in Section IV.10, and  
20 the other terms described in Sections IV.11, IV.12, and IV.13.

21 c. Second Notice

22 With respect to each Eligible Investor that Respondent sent the Notice required by Paragraph  
23 IV.10.b above and who did not respond, Respondent shall provide a second copy of the Notice on or  
24 before March 30, 2012.

25 d. Offer Period

26 i. Respondent shall keep the Purchase Offer open until May 15, 2012 (“Offer  
27 Period”).  
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1           ii.       Eligible Investors may accept the Purchase Offer by notifying Respondent as  
2 described in the Purchase Offer, at any time before 11:59 P.M. Eastern Time, on or before the last  
3 day of the Offer Period. For those Eligible Investors who accept the Purchase Offer within the Offer  
4 Period, Respondent shall purchase or arrange to have purchased their Eligible Auction Rate  
5 Securities by no later than five (5) business days following Respondent's receipt of such Eligible  
6 Investor's acceptance.

7           e.       An Eligible Investor may revoke their acceptance of Respondent's Purchase Offer at  
8 any time up until Respondent's purchase of such Eligible Investor's Eligible Auction Rate Securities.

9           f.       Respondent's obligation to those Eligible Investors who transferred their Eligible  
10 Auction Rate Securities away from Respondent prior to November 16, 2011 shall be contingent on:  
11 (1) Respondent receiving reasonably satisfactory assurances from the financial institution currently  
12 holding the Eligible Investor's Eligible Auction Rate Securities that the bidding rights associated with  
13 such Eligible Auction Rate Securities will be transferred to Respondent; and (2) the transfer to, and  
14 receipt in good order by, Respondent of Eligible Auction Rate Securities.

15           g.       Respondent shall use its best efforts to identify, contact and assist any Eligible  
16 Investor who has transferred the Eligible Auction Rate Securities out of Respondent's custody in  
17 returning such Auction Rate Securities to Respondent's custody, and shall not charge such Eligible  
18 Investor any fees relating to or in connection with the return to Respondent or custodianship by  
19 Respondent of such Eligible Auction Rate Securities.

20           11.       Customer Assistance. By no later than the date of the Initial Notice, Respondent shall  
21 establish a dedicated toll-free telephone assistance line and website to provide information and to  
22 respond to questions concerning the terms of this Order, and to provide information concerning the  
23 terms of this Order and, via an e-mail address or other reasonable means, to respond to questions  
24 concerning the terms of this Order. Respondent shall maintain the telephone assistance line until  
25 August 16, 2012.

26           12.       Relief for Eligible Investors Who Sold Below Par. By January 16, 2012, Respondent  
27 shall use its best efforts to identify each Eligible Investor who: (i) purchased Eligible Auction Rate  
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1 Securities from Respondent on or before February 13, 2008; and (ii) who sold those Eligible Auction  
2 Rate Securities below par between February 13, 2008 and November 16, 2011 (“Below Par Sellers”).  
3 By January 31, 2012, Respondent shall pay each Below Par Seller the difference between par and the  
4 price at which the Below Par Seller sold the Eligible Auction Rate Securities, plus reasonable interest  
5 thereon. Furthermore, Respondent will pay promptly the difference between par and the price at  
6 which the Below Par Seller sold the Eligible Auction Rate Securities, plus reasonable interest thereon  
7 to any Below Par Sellers identified after January 31, 2012.

8 13. Consequential Damages Arbitration Process.

9 a. Respondent shall consent to participate in a special arbitration process (“Arbitration”)  
10 for the exclusive purpose of arbitrating any Eligible Investor’s consequential damages claim arising  
11 from their inability to sell Eligible Auction Rate Securities. In the Arbitration, the Special Arbitration  
12 Process applicable to firms that have entered into settlements with state regulators (the “State SAP”)  
13 will be available for the exclusive purpose of arbitrating any Eligible Investor’s consequential  
14 damages claim. By January 16, 2012, Respondent shall notify Eligible Investors of the terms of the  
15 Arbitration process through the Notice as set forth in Paragraph IV.10.b.

16 b. The Arbitration shall be conducted under the auspices of FINRA, pursuant to the  
17 NASD Code of Arbitration Procedures for Customer Disputes, eff. April 16, 2007. Respondent will  
18 pay all applicable forum and filing fees.

19 c. Any Eligible Investors who choose to pursue such claims in the Arbitration shall bear  
20 the burden of proving that they suffered consequential damages and that such damages were caused  
21 by their inability to access funds invested in Eligible Auction Rate Securities. In the Arbitration,  
22 Respondent shall be able to defend itself against such claims; provided, however, that Respondent  
23 shall not contest liability for the illiquidity of the underlying auction rate securities position or use as  
24 part of its defense any decision by the Eligible Investor not to borrow money from Respondent.

25 d. Eligible Investors who elect to use the Arbitration provided for herein shall not be  
26 eligible for punitive damages, or for any other type of damages other than consequential damages.  
27 However, the State SAP will govern the availability of attorney’s fees.  
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1           14.    Loan Interest Expense.

2           By January 16, 2012, Respondent shall use its best efforts to identify Eligible Investors that  
3 obtained a loan through Respondent (or its affiliates) secured by Eligible Auction Rate Securities that  
4 were not successfully auctioning at the time the loan was taken and who paid more in interest on the  
5 loan than the Eligible Investor received in interest or dividends from the Eligible Auction Rate  
6 Securities during the time the loan was outstanding (“Negative Carry”). Respondent, on or before  
7 January 16, 2012, will reimburse the Eligible Investor the amount of Negative Carry actually paid.

8           15.    Reports and Meetings

9           a.     Respondent shall submit quarterly reports to the Colorado Division of Securities  
10 detailing Respondent’s progress with respect to the provisions of this Order within ten (10) days from  
11 the month when a quarterly report is due, beginning with a report covering the quarter ending  
12 December 31, 2011 and continuing through and including a report covering the quarter ending  
13 December 31, 2012.

14           b.     Beginning December 21, 2011, Respondent shall confer via telephone at least  
15 quarterly with the Colorado Division of Securities regarding Respondent’s progress with respect to  
16 the provisions of this Order. Such quarterly telephone conferences shall continue until December 31,  
17 2012.

18           c.     The reporting and telephone conference deadlines set forth above may be amended or  
19 modified with written permission from the Colorado Division of Securities.

20           d.     At the conclusion of the Purchase Offer, Respondent shall provide a report to the  
21 Colorado Division of Securities concerning all customers nationwide impacted by Respondent’s  
22 Purchase Offer and/or reimbursement to those who sold below par.

23           16.    This Order is not intended to indicate that Respondent or any of its affiliates or current  
24 or former officers, directors, trustees, agents, members, partners, or employees (and of any of  
25 Respondent’s parent companies, subsidiaries or affiliates) shall be subject to any disqualifications  
26 contained in the federal securities laws, the rules and regulations thereunder, the rules and regulations  
27 of self regulatory organizations or various states’ securities laws including any disqualifications from  
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1 relying upon the registration exemptions or safe harbor provisions. In addition, this Order is not  
2 intended to form the basis for any such disqualifications.

3 17. Except in an action by California to enforce the obligations of Respondent in this  
4 Order, this Order may neither be deemed nor used as an admission of or evidence of any alleged  
5 fault, omission or liability of Respondent in any civil, criminal, arbitration or administrative  
6 proceeding in any court, administrative agency or tribunal. For any person or entity not a party to  
7 this Order, this Order does not limit or create any private rights or remedies against Respondent or  
8 any of its affiliates or current or former officers, directors, trustees, agents, members, partners, or  
9 employees (and of any of Respondent's parent companies, subsidiaries or affiliates) including,  
10 without limitation with respect to the use of any emails or other documents of Respondent or of  
11 others concerning the marketing and/or sales of auction rate securities, limit or create liability of  
12 Respondent, or limit or create defenses of Respondent to any claims.

13 18. This Order is not intended to disqualify Respondent or any of its affiliates or current or  
14 former officers, directors, trustees, agents, members, partners, or employees (and of any of  
15 Respondent's parent companies, subsidiaries or affiliates) from any business that they otherwise are  
16 qualified or licensed to perform under applicable state securities law and this Order is not intended to  
17 form the basis for any disqualification. This Order may not be read to indicate that Respondent or any  
18 of its affiliates or current or former officers, directors, trustees, agents, members, partners, or  
19 employees (and of any of Respondent's parent companies, subsidiaries or affiliates) engaged in fraud  
20 or to serve as the basis for any future independent action to establish a violation of any federal laws,  
21 the rules or regulations thereunder, or the rules and regulations of self-regulatory organizations.

22 DATED this 11th day of January, 2012.

23  
24 BY ORDER OF

JAN LYNN OWEN  
California Corporations Commissioner

25  
26 By \_\_\_\_\_  
27 ALAN S. WEINGER  
28 Deputy Commissioner

Enforcement Division

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**CONSENT TO ENTRY OF ADMINISTRATIVE ORDER BY E\*TRADE SECURITIES LLC**

E\*TRADE Securities LLC (“Respondent”) 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, and has waived the same.

Respondent admits the jurisdiction of the Administrator, neither admits nor denies the Findings of Fact and Conclusions of Law contained in this Order, and consents to entry of this Order by Administrator as settlement of the issues contained in this Order.

Respondent shall not claim, assert, or apply for a tax deduction or tax credit with regard to

1 any state, federal, or local tax for any administrative monetary payment that Respondent shall pay  
2 pursuant to this Order.

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

5 James E. Ballowe, Jr represents that he/she is General Counsel of E\*TRADE  
6 Securities LLC and that, as such, has been authorized by E\*TRADE Securities LLC to enter into this  
7 Order for and on behalf of E\*TRADE Securities LLC

8 DATED this 10th day of January, 2012.

E\*TRADE SECURITIES LLC

By: /s/ \_\_\_\_\_

Title: General Counsel \_\_\_\_\_

9 STATE OF \_\_\_\_\_ )  
10 )

11 County of \_\_\_\_\_ )  
12 )  
13 )

14 SUBSCRIBED AND SWORN TO before me this \_\_\_\_\_ day of \_\_\_\_\_, 2012.

15 \_\_\_\_\_  
16 )  
17 Notary Public

18 My commission expires:  
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