

I.

FINDINGS OF FACT

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3 1. CGMI admits the jurisdiction of the Division, neither admits nor denies the Findings
4 of Fact and Conclusions of Law contained in this Order, and consents to the entry of this Order by
5 the Division.

6 2. CGMI (which includes Smith Barney, a division of CGMI) has engaged in the sale of
7 ARS in the state of Alaska.

8 **Auction Rate Securities**

9 3. ARS as a general term refers to long-term debt or equity instruments tied to short-
10 term interest rates that are reset periodically through an auction process.

11 4. An ARS auction is regarded as a "fail" or "failed auction" if there is not a buyer
12 available for every ARS being offered for sale at the auction. In the event of a failed auction, the
13 investors who wished to sell their ARS were unable to do so and would continue to hold the ARS
14 and wait until the next successful auction to liquidate their positions.

15 5. Beginning in February 2008, the ARS market experienced widespread failed auctions
16 (the "2008 Auction Failures").

17 6. Common categories of ARS instruments include: auction preferred shares of closed-
18 end funds ("Preferreds"); municipal auction rate certificates ("Municipal ARS"); and student loan-
19 backed auction rate certificates ("Student Loan ARS"). The interest rates paid to ARS holders are
20 intended to be set through a Dutch auction process.

21 7. The interest rate set at an ARS auction is commonly referred to as the "clearing rate."

22 8. In order to determine the clearing rate, the buy bids are arranged from lowest to
23 highest interest rate (subject to any applicable minimum interest rate). The clearing rate is the
24 lowest interest rate at which all ARS available for sale at the auction can be sold at par value.

1 **CGMI's Activities in the ARS Market**

2 9. Trading of ARS at CGMI is performed by the Short-Term Tax-Exempt Sales and
3 Trading Desk ("Auction Desk").

4 10. CGMI's Auction Desk includes traders and sales coordinators. The sales coordinators
5 on the Auction Desk at times provided information to, and answered questions from, CGMI's
6 financial advisers regarding ARS.

7 11. For approximately twenty (20) years, CGMI has been an underwriter of ARS. The
8 compensation earned for underwriting activities of Preferreds is typically one percent (1%) of the
9 outstanding amount of the ARS underwritten. Since the late 1990s, the compensation for
10 underwriting other types of ARS has generally been a fraction of one percent (.25% to .35%) of the
11 outstanding amount of ARS underwritten.

12 12. CGMI's ARS underwriting activities are primarily handled by investment bankers.
13 The Auction Desk often consulted the investment bankers with respect to various ARS matters.

14 13. The cost of the financing to issuers is directly related to the clearing rates set at the
15 auctions for the issuer's ARS. As an underwriter, CGMI had an interest in providing low-cost
16 financing to the issuers of the ARS that it underwrote because its ability to provide low-cost
17 financing affected the possibility of additional underwriting business.

18 14. CGMI typically served as a manager of ARS auctions. CGMI's roles for each auction
19 were typically set forth in a broker-dealer agreement entered into between CGMI and the ARS
20 issuer.

21 15. CGMI often served as the sole manager of ARS auctions or as the co-manager of
22 auctions with other large broker-dealers.

23 16. CGMI's compensation for serving as an ARS auction manager is typically 25 basis
24 points (annualized) of the ARS amount that CGMI sold to its clients.

1 17. If CGMI was either a sole or co-manager for an ARS, it may also have been
2 designated as the lead or senior manager for the entire offering or for specific tranches of the ARS
3 offering.

4 18. Prior to February 2008, CGMI's practice was to submit cover or support bids in all
5 auctions for which it was the lead broker-dealer.

6 19. CGMI placed support bids to: (1) prevent failed auctions and (2) prevent an auction
7 from clearing at a rate that CGMI believed did not reflect the market for the particular ARS being
8 auctioned.

9 20. For auctions where CGMI was designated a lead manager, it regularly placed support
10 bids for the entire amount of ARS for which CGMI was designated the lead. These support bids
11 ensured that there were enough buyers for every ARS available for sale at the auctions, and as a
12 result, the auctions would not fail.

13 **Marketing and Listing of ARS**

14 21. Prior to the 2008 Auction Failures, CGMI marketed the following statement to its
15 clients: "To date, CGMI, as lead manager, has never been involved in a failed auction."

16 22. CGMI and CGMI personnel marketed and sold ARS to investors in Alaska as money-
17 market alternatives, cash equivalents, and/or liquid investments.

18 23. From on or about August 30, 2006, to until on or about April 10, 2008, CGMI stated
19 on its website that "[f]rom an investor's perspective, and subject to the conditions discussed in more
20 detail below [including the risk of a failed auction and liquidity risk], ARS are generally viewed as
21 an alternative to money market funds."

22 24. ARS are characterized on customer account statements according to the type of
23 security. Until March 2008, CGMI's account statements listed Preferreds under a heading of
24 "Money market and auction instruments."

1 25. Since approximately 2004, CGMI has prepared and provided a document titled
2 "Portfolio Review" (also formally called "Private Client Monitor") to its clients. The Portfolio
3 Review provides a snapshot of client accounts and is a way for CGMI's clients to review their asset
4 allocations and historical performance.

5 26. The asset classes under which ARS are listed on the Portfolio Review include: (1)
6 "Cash" (if the ARS reset period is seven days or less, i.e., floaters) and (2) "Cash Equivalents."

7 27. CGMI did not provide its financial advisers with the training and information
8 necessary to explain adequately ARS products or the mechanics of the auction process to CGMI's
9 clients.

10 **ARS Market from August 2007 to February 2008**

11 28. In or about August and September 2007, some ARS auctions managed by other
12 broker-dealers experienced failures (the "2007 Auction Failures"). These failures were primarily
13 based on credit quality concerns related to the ARS at issue.

14 29. As a result of the 2007 Auction Failures and other market conditions, the ARS market
15 began to see decreases in demand for ARS. Based on the decreasing demand, CGMI accumulated
16 an increasing amount of ARS in its inventory because a higher number of CGMI's support bids were
17 being filled.

18 30. Another effect of the decreasing demand in the ARS market was a general increase in
19 the clearing rates. Given the increase in clearing rates, some ARS issuers contacted CGMI's
20 investment bankers to express their complaints with the cost of their financing and threatened to take
21 future underwriting business to other firms.

22 31. Because of the significant increase in CGMI's ARS inventory, CGMI personnel
23 began to discuss the possibility that there might come a time when CGMI could no longer support
24 the auctions. These discussions started in or about August 2007 and continued until the 2008

1 Auction Failures. During this time, CGMI understood that its withdrawal from the ARS market
2 would result in some auction failures and the illiquidity of ARS held by its clients.

3 32. Throughout the fall of 2007, CGMI advised some ARS issuers to refinance their ARS
4 into other types of financing such as variable rate demand obligations.

5 33. Despite its advice to ARS issuers, on or about November 8, 2007, CGMI increased
6 the sales credit paid to Smith Barney Financial Advisers in connection with the sale of 7-day
7 Municipal ARS.

8 34. CGMI's internal reasons for the increased sales credit included: (1) "move increasing
9 inventory"; (2) make "the product more attractive relative to other options"; (3) "greater pressure on
10 our balance sheet"; and (4) "greater pressure from issuers concerning execution versus competitors."

11 35. On February 11, 2008, CGMI did not place any support bids in auctions for Student
12 Loan ARS. As a result, on that date all of the Student Loan ARS auctions where CGMI was
13 designated the lead manager failed.

14 36. After February 11, 2008, CGMI no longer continued to place support bids on all ARS
15 for which it was designated the lead manager. Subsequently, many auctions then failed, resulting in
16 the illiquidity of billions of dollars invested in ARS.

17 **Auction Desk Tapes**

18 37. CGMI recorded the Auction Desk's phone calls. These calls sometimes included
19 conversations with issuers, other CGMI personnel, and institutional investor clients.

20 38. After a tape was fully recorded, it would be catalogued and maintained for a period of
21 ninety (90) days. Following this 90-day period, the tape would be placed in a pool of tapes available
22 for re-recording. CGMI represents that recycled tapes were randomly selected from the available
23 pool for re-recording.

24

1 1. This Order concludes the investigation by the Division and any other action that the
2 Division could commence under AS 45.55 on behalf of Alaska as it relates to CGMI's marketing and
3 sale of ARS to CGMI's "Eligible Customers," as defined below.

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

6 3. CGMI shall cease and desist from violating the Alaska Securities Act and will comply
7 with the Alaska Securities Act.

8 4. Within ten (10) days from the entry of this Order, CGMI shall pay the sum of One
9 Hundred Fifty Thousand Five Hundred Seven Dollars and Thirty-Eight Cents (\$150,507.38) to the
10 Division, such amount to be restricted to the following specific use by the Division: promoting
11 investor education, investor protection, and compliance with securities laws.

12 5. CGMI shall take certain measures with respect to current and former customers who
13 purchased "Eligible ARS" from CGMI, as defined below.

14 6. Eligible ARS. For purposes of this Order, "Eligible ARS" shall mean auction rate
15 securities that were purchased at CGMI on or before February 12, 2008, and that have failed at
16 auction at least once between August 7, 2008, and December 11, 2008.

17 7. Eligible Customer. As used in this Consent, "Eligible Customer" shall mean:

18 a. Natural persons who purchased ARS at CGMI on or before February 12,
19 2008, and held those securities on February 12, 2008;

20 b. Charities, endowments, or foundations with Internal Revenue Code
21 Section 501(c)(3) status that purchased ARS at CGMI on or before February 12, 2008, and held
22 those securities on February 12, 2008; and

23 c. Small Businesses that purchased ARS at CGMI on or before February 12,
24 2008, and held those securities on February 12, 2008. For purposes of this provision, "Small

1 Businesses" shall mean customers not otherwise covered by paragraph 7(b), above, who had \$10
2 million or less in assets in their accounts with CGMI net of margin loans (or if the customer
3 custodied portions of its investments purchased from CGMI away from CGMI, then had \$10 million
4 or less in assets custodied at CGMI net of margin loans plus those assets purchased from CGMI but
5 custodied elsewhere), as determined by the customer's aggregate household position(s) as of July 31,
6 2008 (if the customer was not a customer of CGMI as of July 31, 2008, then as of the date that the
7 customer terminated its customer relationship with CGMI, except that any customer excluded
8 because it had more than \$10 million in assets purchased from CGMI as of the termination date shall
9 be included if such customer can reasonably show that it held \$10 million or less in assets in its
10 accounts at broker-dealers or other financial institutions where it held investments as of July 31,
11 2008).

12 8. Notwithstanding any other provision, "Small Businesses" does not include: (i) broker-
13 dealers, or (ii) banks acting as conduits for their customers; or (iii) customers who have represented
14 that they had total assets of greater than \$50 million, or otherwise are determined to have had assets
15 greater than \$50 million, as of July 31, 2008.

16 9. In no event shall CGMI be required by this Order to purchase more than \$10 million
17 of ARS from any Small Business.

18 10. Offer period. No later than November 5, 2008, or, for those Eligible Customers not
19 identified prior to November 5, 2008, despite CGMI's best efforts, as soon as practicable thereafter,
20 CGMI shall offer to purchase, at par plus accrued and unpaid dividends/interest, Eligible ARS from
21 Eligible Customers. This offer period shall remain open until at least February 5, 2009 ("Offer
22 Period"). CGMI may extend the Offer Period beyond this date. To the extent that CGMI is made
23 aware that an Eligible Customer did not receive notice of the offer, the Offer Period shall remain
24 open for that Eligible Customer until at least 5:00 pm (Eastern Time) on June 1, 2009.

1 11. Initial Notice. No later than seven (7) business days from December 11, 2008, CGMI
2 shall make best efforts to identify and provide written notice to Eligible Customers, informing them
3 of the relevant terms of the offer to repurchase, the specific security and quantity purchased (where
4 practicable), a statement that the offer may be the only opportunity for the investor to liquidate the
5 ARS holdings, and that the offer to repurchase is being made pursuant to a settlement with various
6 regulators. CGMI shall also provide written notice to any Eligible Customers identified subsequent
7 to the Initial Notice.

8 12. Second Notice. To the extent that any Eligible Customer has not responded to
9 CGMI's offer to purchase their Eligible ARS, CGMI shall make best efforts to provide any such
10 Eligible Customer a second written notice on or before forty-five (45) days before the end of the
11 Offer Period including the terms detailed in paragraph III(11) above, notifying them of the
12 impending expiration of the Offer Period, describing the state of the ARS market at that time, and
13 explaining the consequences of failing to sell their ARS to CGMI prior to the expiration of the Offer
14 Period.

15 13. Notification to Customers Who Purchased ARS at Other Firms. With respect to
16 CGMI customers who hold ARS in their accounts at CGMI that were purchased at other firms, by no
17 later than forty-five (45) days from December 11, 2008, CGMI shall use best efforts to notify such
18 customers that they should contact those firms directly to determine whether they are extending an
19 offer to purchase the customers' ARS.

20 14. Customer Assistance Line. No later than two (2) business days from December 11,
21 2008, CGMI shall establish a dedicated toll-free telephone assistance line, with appropriate staffing,
22 to provide information and to respond to questions concerning the terms of this Order. CGMI shall
23 maintain this dedicated telephone assistance line through December 31, 2009.

24 15. Purchase Acceptance Deadline. Eligible Customers may accept CGMI's offer to

1 purchase Eligible ARS by notifying CGMI within the Offer Period and consistent with the
2 provisions of paragraphs III(16) and III(17), below.

3 16. Purchases Relating to Eligible Customers Who Custody Their Eligible ARS at CGMI.

4 For Eligible Customers who custodied their Eligible ARS at CGMI as of August 31, 2008:

5 a. If CGMI receives notification of acceptance of its purchase offer on or before
6 October 21, 2008, CGMI shall purchase the Eligible ARS from the Eligible Customer on or before
7 November 5, 2008; or

8 b. If CGMI receives notification of acceptance of its purchase offer after
9 October 21, 2008, but within the Offer Period, CGMI shall purchase the Eligible ARS on or before
10 the next scheduled auction date that occurs (i) after November 5, 2008, and (ii) after three (3)
11 business dates after CGMI's receipt of notification.

12 17. Purchases Relating to Eligible Customers Who Custody Their Eligible ARS Away
13 From CGMI. For Eligible Customers who custodied their Eligible ARS away from CGMI as of
14 August 31, 2008:

15 a. If CGMI receives: (i) notification of acceptance of its purchase offer on or
16 before December 5, 2008; (ii) assurance reasonably satisfactory to CGMI from the customer's
17 current financial institution that the bidding rights associated with the ARS will be transferred to the
18 CGMI; and (iii) transfer of the ARS, then CGMI shall purchase the Eligible ARS as soon as
19 reasonably practicable but no later than December 23, 2008; or

20 b. If CGMI receives: (i) notification of acceptance of its purchase offer after
21 December 5, 2008, but within the Offer Period; (ii) assurance reasonably satisfactory to CGMI from
22 the customer's current financial institution that the bidding rights associated with the ARS will be
23 transferred to the CGMI; and (iii) transfer of the ARS, then CGMI shall purchase the Eligible ARS

1 as soon as reasonably practicable but no later than the next scheduled auction date that occurs (1)
2 after December 23, 2008, and (2) after three (3) business dates after CGMI's receipt of notification.

3 c. CGMI shall use its best efforts to identify, contact, and assist any Eligible
4 Customer who has transferred the ARS out of CGMI's custody in returning such ARS to CGMI's
5 custody, and shall not charge such Eligible Customer any fees relating to or in connection with the
6 return to CGMI or custodianship by CGMI of such ARS.

7 18. Relief for Investors Who Sold Below Par. CGMI shall make best efforts to identify
8 any Eligible Customers who sold Eligible ARS below par between February 11, 2008, and
9 December 11, 2008. By November 5, 2008, CGMI shall pay any such identified Eligible Customers
10 the difference between par and the price at which the Eligible Customer sold the Eligible ARS, plus
11 reasonable interest thereon. CGMI shall promptly pay any such Eligible Customers identified
12 thereafter.

13 19. Relief Efforts for Institutional and Other Customers. CGMI shall endeavor to work
14 with issuers and other interested parties, including regulatory and governmental entities, to
15 expeditiously and on a best-efforts basis provide liquidity solutions, by December 31, 2009, for
16 institutional investors and other customers who purchased Eligible ARS from CGMI on or before
17 February 12, 2008, and are not otherwise covered by paragraph III(7), above.

18 20. Reimbursement for Related Loan Expenses. CGMI shall make best efforts to identify
19 Eligible Customers who took out loans secured by Eligible Auction Rate Securities that were not
20 successfully auctioning at the time the loan was taken out from CGMI between February 11, 2008,
21 and December 23, 2008, and paid interest associated with the auction rate securities based portion of
22 those loans in excess of the total interest and dividends received on the auction rate securities during
23 the duration of the loan. CGMI shall reimburse such customers for the excess expense, plus
24 reasonable interest thereon. Such reimbursement shall have occurred no later than March 31, 2009.

1 21. Refund of Refinancing Fees to Municipal Issuers. By January 1, 2009, CGMI shall
2 refund to municipal issuers underwriting fees the issuer paid CGMI for the refinancing or conversion
3 of their ARS that occurred after February 11, 2008, where CGMI acted as underwriter for both the
4 primary offering of ARS between August 1, 2007, and February 11, 2008, and the refunding or
5 conversion of the ARS after February 11, 2008.

6 22. Reports to NASAA. Within twenty (20) days of the end of each month, beginning
7 with a report covering the month ended November 30, 2008 (due on December 20, 2008) and
8 continuing through and including a report covering the month ended December 31, 2009 (due on
9 January 20, 2010), CGMI shall submit a monthly written report detailing the efforts in which CGMI
10 has engaged and the results of those efforts with respect to CGMI's institutional investors' holdings
11 in ARS. The report shall be submitted to a representative specified by the North American
12 Securities Administrators Association ("NASAA"). Beginning in March 2009, CGMI shall meet
13 quarterly with a designated NASAA representative to discuss its progress with respect to its
14 obligations pursuant to this Order. Such quarterly meetings shall continue until no later than
15 December 2009. The reporting or meeting deadlines set forth above may be amended with written
16 permission from a designated NASAA representative.

17 23. Consequential Damages Claims. CGMI shall consent to participate, at the Eligible
18 Customer's election, in the special arbitration procedures as briefly described below. Under these
19 procedures, an arbitration process, under the auspices of the Financial Industry Regulatory Authority
20 ("FINRA"), will be available for the exclusive purpose of arbitrating any Eligible Customer's
21 consequential damages claim. These arbitrations will be governed by the procedures described
22 briefly below.

23 a. Arbitrator. Arbitration shall be conducted by a single public arbitrator.

24 b. Forum Fees. CGMI will pay all forum fees associated with the arbitration for

1 Eligible Customers.

2 c. Burden of Proof. Customers shall bear the burden of proving by a
3 preponderance of the evidence the existence and amount of consequential damages suffered as a
4 result of the illiquidity of the Eligible ARS. Although it may defend itself against consequential
5 damage claims, CGMI shall not argue against liability for the illiquidity of the underlying ARS
6 position or use as part of its defense any decision by the Eligible Customer not to borrow money
7 from CGMI.

8 d. Other Damages. Eligible Customers who elect to use the special arbitration
9 procedures provided for in this Order shall not be eligible for punitive damages, or any other type of
10 damages other than consequential damages.

11 24. Other Proceedings/Relief. All customers, including but not limited to Eligible
12 Customers who avail themselves of the relief provided pursuant to this Order, may pursue any
13 remedies against CGMI available under the law. However, those customers that elect to utilize the
14 special arbitration procedures set forth above, rather than regular arbitration at FINRA, are limited to
15 the remedies available in the special arbitration process and may not bring or pursue a claim relating
16 to ARS in another forum.

17 IV.

18 Additional Considerations

19 1. In consideration of the settlement, the Division will refrain from taking legal action,
20 excluding this Order, against CGMI with respect to CGMI's marketing and sale to its institutional
21 investors until a date after December 31, 2009.

22 2. If payment is not made by CGMI, or if CGMI defaults in any of its obligations set
23 forth in this Order, the Division may vacate this Order, at its sole discretion, upon 10-days notice to
24 CGMI and without opportunity for administrative hearing.

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

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

11 5. Nothing herein shall preclude Alaska, its departments, agencies, boards, commissions,
12 authorities, political subdivisions and corporations, other than the Division, and only to the extent set
13 forth in paragraphs III(1) and IV(1), above (collectively, "State Entities"), and the officers, agents or
14 employees of State Entities from asserting any claims, causes of action, or applications for
15 compensatory, nominal and/or punitive damages, administrative, civil, criminal, or injunctive relief
16 against CGMI in connection with the marketing and sale of ARS by CGMI.

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

20 7. This Order and any dispute related thereto shall be construed and enforced in
21 accordance with, and governed by, the laws of Alaska without regard to any choice of law
22 principles.

23 8. CGMI, through its execution of this Consent Order, voluntarily waives its right to a
24 hearing on this matter and to judicial review of this Consent Order under AS 45.55.

STATE OF ALASKA
DEPARTMENT OF COMMERCE, COMMUNITY, AND ECONOMIC DEVELOPMENT
DIVISION OF BANKING AND SECURITIES
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9. CGMI enters into this Consent Order voluntarily and represents that no threats, offers, promises, or inducements of any kind have been made by the Division, or any member, officer, employee, agent, or representative of the Division, to induce CGMI to enter into this Consent Order.

10. This Order shall be binding upon CGMI and its successors and assigns as well as to successors and assigns of relevant affiliates with respect to all conduct subject to the provisions above and all future obligations, responsibilities, undertakings, commitments, limitations, restrictions, events, and conditions.

IT IS SO ORDERED this 9th day of November, 2010.

State of Alaska
Department of Commerce, Community, and
Economic Development
Division of Banking and Securities

/s/ Lorie L. Hovanec
By: Lorie L. Hovanec, Director

