

OPEN MEETING ITEM

9/10/09

COMMISSIONERS
KRISTIN K. MAYES, Chairman
GARY PIERCE
PAUL NEWMAN
SANDRA D. KENNEDY
BOB STUMP



0000101933

1300 West Washington, Third Floor
Phoenix, AZ 85007
TELEPHONE: (602) 542-4242
FAX: (602) 594-7470
E-MAIL: securitiesdiv@azcc.gov

ARIZONA CORPORATION COMMISSION

Arizona Corporation Commission
DOCKETED

ORIGINAL

AUG 25 2009

MEMORANDUM

TO: Kristin K. Mayes, Chairman
Gary Pierce, Commissioner
Paul Newman, Commissioner
Sandra D. Kennedy, Commissioner
Bob Stump, Commissioner

FROM: Matthew J. Neubert, Director of Securities *[Signature]*

DATE: August 21, 2009

RE: JPMorgan Chase & Co.
Docket No. S-20687A-09-0315

cc: Ernest G. Johnson, Executive Director

DOCKETED BY	<i>[Signature]</i>
-------------	--------------------

RECEIVED
2009 AUG 25 P 12:16
AZ CORP COMMISSION
DOCKET CONTROL

The Securities Division recommends that the Corporation Commission enter the attached Order for Administrative Penalties and Consent to Same by Respondent JPMorgan Chase & Co. ("Consent Order"). The Consent Order relates to activities of JPMorgan Chase & Co. ("JPMorgan") regarding the offer and sale of auction rate securities. The proposed Consent Order imposes an administrative penalty in the amount of \$348,779.49.

As you are aware, as a result of the February 2008 wide spread auction failures in the auction rate securities market, in March 2008 the North American Securities Administrators Association (NASAA) formed a multistate task force, with which the Securities Division participated, to investigate the auction rate securities market. The investigations focused on the sales practices of securities salesmen and the supervision of those salesmen by their broker-dealers. In August 2008, JPMorgan agreed in principle to a national settlement. In order to provide for uniformity among the states, the NASAA task force created a model consent order. The findings of fact and conclusions of law contained in the attached proposed Consent Order were negotiated between JPMorgan and the lead task force state.

The principal components of the settlement are:

- Payment of administrative penalties in the amount of \$25 million dollars, apportioned among the states.
- An offer to purchase from eligible customers at par auction rate securities that were purchased from JPMorgan prior to February 12, 2008.

- Payment of the difference between par and the price at which an individual investor sold the auction rate securities to each individual investor who sold auction rate securities below par between February 12, 2008, and announcement of the August settlement.
- A refund of refinancing fees to municipal auction rate issuers that issued through respondent in the initial primary market between August 1, 2007, and February 12, 2008, and refinanced those securities through respondent after February 12, 2008.
- Respondent's efforts to expeditiously provide liquidity solutions for institutional investors.

In light of the significant effort undertaken by the NASAA task force members in investigating JPMorgan and the relief JPMorgan has provided to investors in auction rate securities, the Securities Division believes that entry of the proposed Consent Order is in the public interest.

Originator: Matthew J. Neubert

BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

KRISTIN K. MAYES, Chairman
GARY PIERCE
PAUL NEWMAN
SANDRA D. KENNEDY
BOB STUMP

In the matter of
JPMORGAN CHASE & CO.,
Respondent.

DOCKET NO. S-20687A-09-0315

DECISION NO. _____

ORDER TO CEASE AND DESIST, ORDER
FOR ADMINISTRATIVE PENALTIES, AND
CONSENT TO SAME
BY: RESPONDENT JPMORGAN CHASE &
CO.

WHEREAS, certain affiliates of JPMorgan Chase & Co. are dealers registered in the state of Arizona; and

WHEREAS, an investigation into the activities of JPMorgan Chase & Co. and its subsidiaries and affiliates, including J.P. Morgan Securities Inc., Chase Investment Services Corporation, and Bear Stearns & Co. and affiliates, with the exception of WaMu Investments Inc., which JPMorgan acquired on September 25, 2008 (hereinafter "JPMorgan") in connection with certain of its marketing and sale of auction rate securities practices during the period of approximately January 2006 through the present has been conducted under the auspices of a multistate task force; and

WHEREAS, JPMorgan has cooperated with regulators conducting the investigation by responding to inquiries, providing documentary evidence and other materials, and providing regulators with access to facts relating to the investigation; and

WHEREAS, JPMorgan has advised regulators that it desires to settle and resolve the investigations without admitting or denying the allegations set forth below; and

1 WHEREAS, JPMorgan agrees to take certain actions described herein and to make certain
2 payments; and

3 WHEREAS, JPMorgan elects to permanently waive any right to a hearing and appeal under
4 Articles 11 and 12 of the Securities Act of Arizona, A.R.S. § 44-1801 *et seq.* (“Securities Act”)
5 with respect to this Order to Cease and Desist and Order for Administrative Penalties (the “Consent
6 Order”);

7 NOW, THEREFORE, the Arizona Corporation Commission (“Commission”), as
8 administrator of the Securities Act, hereby enters this Consent Order.

9
10 I.

11 **FINDINGS OF FACT**

12 1. JPMorgan admits the jurisdiction of the Commission, neither admits nor denies the
13 Findings of Fact and Conclusions of Law contained in this Consent Order, and consents to the
14 entry of this Consent Order by the Commission.

15 2. Auction rate securities are financial instruments that include auction preferred
16 shares of closed-end funds, municipal auction rate bonds, and student loan-backed auction rate
17 bonds (collectively referred to herein as “ARS”). While ARS are all long-term instruments, one
18 significant feature of ARS (which historically provided the potential for short-term liquidity) is the
19 interest/dividend reset through periodic auctions. If an auction is successful (i.e., there are enough
20 buyers for every ARS being offered for sale at the auction), investors are able to sell their ARS on
21 a short-term basis. If, however, auctions “fail” (i.e., there are not enough buyers for every ARS
22 being offered for sale), investors may be required to hold all or some of their ARS until the next
23 successful auction in order to liquidate their funds.

24
25
26

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

2 3. Although JPMorgan was aware of increasing strains in areas of the ARS market
3 during the approximate six (6) months prior to the mass failure, JPMorgan failed to ensure that all
4 of its registered representatives made appropriate disclosures to customers regarding the nature and
5 risks of auction rate securities. Certain JPMorgan employees stated that auction rate securities
6 were liquid, safe, short-term investments and did not highlight the risk that, in the event of a failed
7 auction, the securities might become illiquid.

8 4. JPMorgan used the proprietary name, M-Stars or Municipal Short Term Auction
9 Rate Securities, in marketing ARS. This could have led certain investors to conclude that ARS
10 were short-term instruments. In fact, ARS were not simply "short-term" instruments. For example,
11 certain student loan MSTARS had maturities in the year 2039 and full liquidity was only available
12 at an auction if the auction was successful.

13 5. Starting in the Fall of 2007, demand for certain auction rate securities continued to
14 erode and JPMorgan's auction rate securities inventory grew significantly. JPMorgan did not
15 discuss the increasing risks of owning or purchasing auction rate securities with all of its
16 customers.

17 6. In February 2008, JPMorgan stopped uniformly supporting auctions for which it
18 acted as the sole or lead broker. Without the benefit of support bids from broker-dealers, the
19 auction rate securities market collapsed, leaving certain investors who had believed that these
20 securities were liquid, safe, short-term investments appropriate for managing short-term cash
21 needs, holding long-term securities that could not be sold at par value.

22 **Failure to Supervise Agents who Sold ARS**

23 7. JPMorgan did not provide all its sales or marketing staff with the training and
24 information necessary to adequately explain these products or the mechanics of the auction process
25 to their customers.

26

1 8. Not all of JPMorgan's registered associated persons were adequately educated in the
2 ARS products they were selling.

3 9. JPMorgan failed to reasonably supervise all its employees, by among other things:

4 a. failing to provide adequate training to all its registered agents regarding ARS
5 by, among other things:

6 i. failing to provide to all of its registered agents timely and
7 comprehensive sales and marketing literature regarding ARS and the mechanics of
8 the auction process;

9 ii. failing to provide to all of its registered agents all pertinent
10 information concerning the ARS product;

11 iii. failing to provide to all of its registered agents all pertinent
12 information regarding the state of the market prior to the mass auction failures in
13 mid-February, 2008; and

14 b. failing to review ARS transactions in accounts of certain customers who
15 needed liquidity; and

16 c. failing to ensure that all its registered personnel were providing adequate
17 information regarding ARS to its customers.

18 **II.**

19 **CONCLUSIONS OF LAW**

20 1. The Commission has jurisdiction over this matter pursuant to Article XV of the
21 Arizona Constitution and the Securities Act.

22 2. As described in the Findings of Fact above, JPMorgan failed to supervise all its
23 agents and employees and engaged in unethical practices within the meaning of A.R.S. §§ 44-
24 1961(A)(12) and (13).
25
26

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26

3. As a result, the Commission finds this Consent Agreement and the following relief appropriate, in the public interest, and consistent with the Securities Act.

III.
ORDER

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

IT IS HEREBY ORDERED:

1. Entry of this Consent Order concludes the investigation by the Commission and any other action that the Commission could commence under applicable Arizona law on behalf of Arizona as it relates to JPMorgan, relating to certain sale and marketing of auction rate securities at JPMorgan; provided, however, that excluded from and not covered by this paragraph are any claims by the Commission arising from or relating to violations of the provisions contained in this Consent Order.
2. This Consent Order is entered into solely for the purpose of resolving the referenced multistate investigation and is not intended to be used for any other purpose.
3. JPMorgan will CEASE AND DESIST from violating the Securities Act, and will comply with the Securities Act.
4. Within ten days of the date of this Consent Order, JPMorgan shall pay the sum of Three Hundred Forty-eight Thousand Seven Hundred Seventy-nine and 49/100 Dollars (\$348,779.49) to the state of Arizona. The payment to the state of Arizona shall be in the form of a certified or bank check made out to the "State of Arizona." This amount constitutes the state of Arizona's proportionate share of the state settlement amount of \$25 Million Dollars (\$25,000,000.00).
5. In the event another state securities regulator determines not to accept the recommendation of the NASAA Task Force and does not enter into a settlement with JPMorgan

1 that follows the terms of the Settlement Term Sheet signed by JPMorgan, the North American
2 Securities Administrators' Association, and the state of Florida, Office of Financial Regulation, on
3 August 14, 2008, the total amount of Arizona's payment shall not be affected, and shall remain at
4 \$348,779.49.

5 6. JPMorgan shall comply (and, to the extent the Settlement Term sheet described
6 herein required action to be take prior to the date of this Consent Order, has already complied) with
7 the requirements of the Settlement Term Sheet executed August 14, 2008, which provides:

8 a. Individual Investors

9 As soon as practicable following the execution of the Settlement Term Sheet,
10 JPMorgan will offer to buy back at par auction rate securities that since February 12, 2008,
11 have not been auctioning from individual investors who purchased those auction rate
12 securities from JPMorgan prior to February 12, 2008 ("Individual Investors"). For
13 purposes of the Settlement, charities and small to medium-sized businesses with account
14 values and household values up to \$10 million will also be treated as JPMorgan Individual
15 Investors. The term Individual Investors does not include senior management of JPMorgan
16 and its predecessors and JPMorgan financial advisors/registered representatives.

17 The buybacks will be completed no later than November 12, 2008.

18 JPMorgan will provide notice to customers of the settlement terms and JPMorgan
19 will establish a dedicated telephone assistance line, with appropriate staff, to respond to
20 questions from customers concerning the terms of the settlement.

21 b. Relief for Investors Who Sold Below Par

22 No later than November 12, 2008, any JPMorgan Individual Investor that JPMorgan
23 can reasonably identify who sold auction rate securities below par between February 12,
24 2008, and announcement of the Settlement will be paid the difference between par and the
25 price at which the investor sold the auction rate securities.
26

1 c. Consequential Damages Claims

2 No later than November 12, 2008, JPMorgan shall notify those JPMorgan clients
3 who own auction rate securities, pursuant to the terms of the Settlement, that a public
4 arbitrator (as defined by Section 12100(u) of the NASD Code of Arbitration Procedures for
5 Customer Disputes, eff. April 16, 2007), under the auspices of FINRA, will be available for
6 the exclusive purpose of arbitrating any JPMorgan Individual Investor's consequential-
7 damages claim.

8 Arbitration shall be conducted by public arbitrators and JPMorgan will pay all
9 applicable forum and filing fees. Any JPMorgan Individual Investors who choose to pursue
10 such claims shall bear the burden of proving that they suffered consequential damages and
11 that such damages were caused by investors' inability to access funds consisting of
12 investors' auction rate securities holdings at JPMorgan. JPMorgan shall be able to defend
13 itself against such claims; provided, however, that JPMorgan shall not contest in these
14 arbitrations liability related to the sale of auction rate securities. Special or punitive
15 damages shall not be available in the arbitration proceedings.

16 d. Institutional Investors

17 JPMorgan shall endeavor to continue to work with issuers and other interested
18 parties, including regulatory and governmental entities, to expeditiously provide liquidity
19 solutions for institutional investors not covered by paragraph 6.a. above, that continue to
20 hold auction rate securities purchased from JPMorgan ("Institutional Investors").

21 Within 45 days of the end of each quarter beginning with a report covering the
22 quarter ended December 31, 2008 (due on February 14, 2009), and continuing through and
23 including a report covering the quarter ended December 31, 2009 (due on February 14,
24 2010), JPMorgan shall submit a quarterly written report detailing JPMorgan's progress with
25 respect to its obligations pursuant to this Consent Order and outlining the efforts in which
26

1 JPMorgan has engaged and the results of those efforts with respect to JPMorgan's
2 institutional investors' holdings in auction rate securities. JPMorgan shall confer with
3 William F. Reilly, Bureau Chief, Bureau of Securities Regulation, of the state of Florida,
4 Office of Financial Regulation, as the lead NASAA member on behalf of all the states, on a
5 quarterly basis to discuss JPMorgan's progress to date. Such quarterly reports and
6 conferences/meetings shall continue until the first quarter of 2010. Following every
7 quarterly meeting, the state of Florida, Office of Financial Regulation, shall advise
8 JPMorgan of any concerns regarding JPMorgan's progress in providing liquidity solutions
9 for Institutional Investors and, in response, JPMorgan shall detail the steps that JPMorgan
10 plans to implement to address such concerns. The reporting or meeting deadlines set forth
11 above may be amended with written permission from the state of Florida, Office of
12 Financial Regulation.

13 e. Relief for Municipal Issuers

14 JPMorgan shall refund underwriting fees JPMorgan has received from municipal
15 auction rate issuers that issued such securities through JPMorgan in the initial primary
16 market between August 1, 2007, and February 12, 2008, and refinanced those securities
17 through JPMorgan after February 12, 2008, through the date this Consent Order is executed
18 by JPMorgan.

19 f. In consideration of the Settlement

20 The Commission will:

21 i. Terminate its investigation with respect to JPMorgan's marketing
22 and sale of auction rate securities to Individual Investors defined in paragraph 6.a.
23 above. However, nothing herein limits the ability of the Commission in pursuing
24 any investigation relating to any party other than JPMorgan.
25

26

1 ii. Refrain from taking legal action, excluding entry of this Consent
2 Order, against JPMorgan with respect to its institutional investors until
3 November 12, 2008; the Commission shall issue continuances of that period as it
4 deems appropriate; and

5 iii. Accept payment of \$348,779.49 as its portion of the above-
6 mentioned \$25 million penalty, to address all underlying conduct relating to the
7 marketing and sale of auction rate securities. The Commission will not seek
8 additional monetary penalties from JPMorgan relating to such conduct.

9 7. If payment is not made by JPMorgan or if JPMorgan materially defaults in any of its
10 obligations set forth in this Consent Order and fails to cure such a default reasonably after ten (10)
11 days notice from the Commission, notwithstanding any other provision of Arizona law, the
12 Commission may vacate this Consent Order at its sole discretion and without opportunity for
13 administrative hearing.

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

20 9. Nothing herein shall preclude the state of Arizona, its departments, agencies,
21 boards, commissions, authorities, political subdivisions, and corporations (collectively "State
22 Entities"), other than the Commission and only to the extent set forth in paragraph 1 above, and the
23 officers, agents, or employees of State Entities from asserting any claims, causes of action, or
24 applications for compensatory, nominal and/or punitive damages, administrative, civil, criminal, or
25
26

1 injunctive relief against JPMorgan in connection with certain marketing and sales practices of
2 auction rate securities at JPMorgan.

3 10. Except in an action by the Commission to enforce the obligations of JPMorgan in
4 this Consent Order, this Consent Order may neither be deemed nor used as an admission of or
5 evidence of any alleged fault, omission, or liability of JPMorgan in any civil, criminal, arbitration,
6 or administrative proceeding in any court, administrative agency, or tribunal. For any person or
7 entity not a party to this Consent Order, this Consent Order does not limit or create any private
8 rights or remedies against JPMorgan including, without limitation with respect to the use of any e-
9 mails or other documents of JPMorgan or of others concerning the marketing and/or sales of
10 auction rate securities, limit or create liability of JPMorgan, or limit or create defenses of
11 JPMorgan to any claims.

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

15 12. Any dispute related to this Consent Order shall be construed and enforced in
16 accordance with, and governed by, the laws of the state of Arizona without regard to any choice of
17 law principles.

18 13. Respondent, JPMorgan, through its execution of the Consent to this Consent Order,
19 voluntarily waives its right to a hearing on this matter and to judicial review of the Consent Order
20 under Articles 11 and 12 of the Securities Act.

21 14. Respondent, JPMorgan, enters into this Consent Order voluntarily and represents
22 that no threats, offers, promises, or inducements of any kind have been made by the Commission or
23 any member, officer, employee, agent, or representative of the Commission to induce JPMorgan to
24 enter into this Consent Order other than as set forth in this Consent Order.

25
26

1 15. This Consent Order shall be binding upon JPMorgan and its successors and assigns
2 as well as to successors and assigns of relevant affiliates with respect to all conduct subject to the
3 provisions above and all future obligations, responsibilities, undertakings, commitments,
4 limitations, restrictions, events, and conditions.

5 IT IS FURTHER ORDERED that this Order shall become effective immediately.

6 BY ORDER OF THE ARIZONA CORPORATION COMMISSION

7
8 _____
9 CHAIRMAN

10 _____
11 COMMISSIONER

12 _____
13 COMMISSIONER

14 _____
15 COMMISSIONER

16 _____
17 COMMISSIONER

18 IN WITNESS WHEREOF, I, ERNEST G. JOHNSON,
19 Executive Director of the Arizona Corporation
20 Commission, have hereunto set my hand and caused the
21 official seal of the Commission to be affixed at the
22 Capitol, in the City of Phoenix, this _____ day of
23 _____, 2009.

24 _____
25 ERNEST G. JOHNSON
26 EXECUTIVE DIRECTOR

27 _____
28 DISSENT

29 _____
30 DISSENT

31 This document is available in alternative formats by contacting Shaylin A. Bernal, ADA
32 Coordinator, voice phone number 602-542-3931, e-mail sabernal@azcc.gov.

33 (mn)

CONSENT TO ENTRY OF ADMINISTRATIVE ORDER BY JPMORGAN

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

2. JPMorgan admits the jurisdiction of the Commission, neither admits nor denies the Findings of Fact and Conclusions of Law contained in the foregoing Consent Order, and consents to entry of this Consent Order by the Commission as settlement of the issues contained in the foregoing Consent Order.

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

4. JPMorgan states that no promise of any kind or nature whatsoever that is not reflected in this Consent Order was made to it to induce it to enter into this Consent Order and that it has entered into this Consent Order voluntarily.

5. Lawrence N. Chonen represents that he/she is Senior Vice President and Associate General Counsel of JPMorgan and that, as such, has been authorized by JPMorgan to enter into this Consent Order for and on behalf of JPMorgan.

Dated this 17th day of July, 2009.

JPMORGAN CHASE & CO.

By Lawrence N. Chonen
Its Senior Vice President
Associate General Counsel

State of New York)
County of New York) ss

SUBSCRIBED AND SWORN TO before me this 17th day of July, 2009.

Susan McNamara
Notary Public

My commission expires:

1 SERVICE LIST FOR: JPMORGAN CHASE & CO.

2 DOCKET NO.: S-20687A-09-0315

3 Matthew J. Neubert, Director
4 Securities Division
5 Arizona Corporation Commission
6 1300 West Washington Street, 3rd Floor
7 Phoenix, AZ 85007

8 Peter H. Bresnan, Esq.
9 Simpson Thacher & Bartlett LLP
10 12th Floor
11 1155 F Street, NW
12 Washington, DC 20004

13

14

15

16

17

18

19

20

21

22

23

24

25

26

27

28

29