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Midwest

Vol 5 Issue 3

Securities Law Update

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Kruske Law Firm Selected to 2008 Missouri & Kansas Super Lawyers

» **About the Firm**

Visit the firm on-line at www.kruskelaw.com to learn more about current securities industry news, the law firm, securities arbitration and litigation FAQs, download articles and reports, schedule a free consultation, and more.

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Devoted to Representing Investors in Securities Disputes

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About the Firm

Our sole focus is securities arbitration and litigation. We do not seek out personal injury cases, criminal appointments, domestic matters, or corporate defense work. All day, every day, our practice is devoted to representing investors. Because of that focus, we can provide superior advice in this specialized area.

Within the securities industry, we are strongly committed to raising the standard of conduct among financial professionals. We work closely with the Kansas and Missouri Securities Commissioners' Office in local and state government, and local, state, and national bar associations.

Our office, located in metropolitan Kansas City, represents investors ranging from young adults to elderly retirees; and from blue-collar workers to corporate executives. Every public citizen is entitled to the protection of state and federal securities laws, and every investor deserves to be protected from rogue brokers and unethical sales practices employed by brokerage firms across the nation.

Our office is committed to giving clients thoughtful advice about their investment situations. The office often joins forces with locally and nationally-recognized securities experts in order to provide the best representation for each client.

Jeff Kruske is currently a member of the Kansas Bar, Missouri Bar, Kansas Trial Lawyers Association, Johnson County Bar Association, the Public Investors Arbitration Bar Association, and is an FINRA-licensed arbitrator.



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Subprime: When Fixed

IN Focus: Income Becomes Risky

Historically, stocks have made lots of money for lots of people; they have also helped many investors lose their shirts. Risk-averse investors, especially those that felt the sting of the 2000-2003 bear market, sought refuge in fixed-income investments, such as bonds and money market funds. In recent months, however, those who consider those investments a safe harbor for their money have been unpleasantly surprised.

Most investors who are retired or nearing retirement should have a good portion of their assets in fixed-income investments. Many investors in this demographic invested in bonds and cash alternatives under the assumption that those investments would be conservative enough to preserve their retirement nest egg.

As some bond funds have demonstrated, however, fixed-income can be increasingly risky, especially when the true nature of the investments is not disclosed to the investor. For example, Morgan Keegan, a brokerage firm located in Jefferson City, Missouri sold its own bond funds to investors as conservative and safe investments.

However, Morgan Keegan began increasing its holdings in risky subprime mortgage-backed securities, and failed to inform investors of that important fact. Sadly, Morgan Keegan investors learned the hard way by watching many of their "safe" bond funds decline in value by more than 50 percent.

Charles Schwab & Co. made the same fateful decision with their own YieldPlus bond fund (see Current Investigations

on page 3). YieldPlus was marketed as a conservative bond fund. The fund was supposed to invest in "ultra" short-term, low-risk debt instruments that would not subject it to significant liquidity risks or fluctuations in share price. Instead, Schwab caused the fund to invest heavily in high-risk, mortgage-backed instruments, including complex illiquid instruments. Approximately 40% of the Fund's assets were invested in complex mortgage-backed instruments known as Collateralized Mortgage Obligations ("CMOs").

Falcon and ASTA/MAT, two hedge funds managed by Citigroup and marketed to investors as safe funds with losses not to exceed 5%, have seen their collective value all but disappear. Citigroup's brokers had sold Falcon and ASTA/MAT as investment funds suitable for conservative retirees. The funds' value has decreased by 75-90%. Even as the funds deteriorated, Citigroup still assured brokers and clients that the funds were expected to make a rebound. ASTA/MAT invested mainly in municipal bonds while Falcon invested in municipal bonds, mortgage-backed securities, bank loans and other debt instruments.

While not a bond fund, investments in the financial sector over the past year should be questioned by investors. Sensing a bottom, many brokers loaded up their clients with stocks like Citigroup, Merrill Lynch, Lehman Brothers, and even Bear Stearns. Fannie Mae and Freddie Mac were also highly recommended to many investors

CURRENT INVESTIGATIONS

In this issue (page 3) we are highlighting current investigations and claims being filed by our clients, including:

- Schwab "YieldPlus" Claims
- Citigroup ASTA/MAT Funds
- Fannie & Freddie Preferred Stock

Want to be an Arbitrator?

The success of securities arbitration depends on the quality of the arbitrators who hear and decide the dispute presented by the parties. There is a need for new applicants in Kansas and Missouri to serve as FINRA arbitrators. Arbitrators are carefully selected from a broad cross-section of people, diverse in culture, profession, and background. If you have at least five years of business or professional experience, you may qualify to serve. Please contact the Law Office of Jeffrey S. Kruske if you are interested in applying to become an FINRA arbitrator.

This newsletter is intended for informational purposes only, as a way for investors to gain a better understanding of their rights. The information contained within this newsletter is not legal advice and should therefore not be relied upon as such.

If you do not wish to receive this mailing, please contact the Law Office of Jeffrey S. Kruske.



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About The Firm

Types of Claims Typically Handled

Unsuitability

Customer alleges that the broker recommended investments that were not appropriate for his or her investment goals, or even his age and investment objectives.

Material Misrepresentations or Omissions

Customer alleges that the broker intentionally misled him or failed to disclose a material fact about an investment.

Failure to Diversify

Customer alleges that the broker over concentrated their portfolios in minimal sectors.

Variable Annuities and Equity-Indexed Annuities

Carry very high expenses, and earn brokers very large commissions.

Churning

Customer alleges that the broker purchased and sold securities solely to generate commissions, without regard to the customer's investment objectives or goals.

Unauthorized Trading

Customer alleges that the broker entered transactions into the account without the customer's knowledge or approval.

Breach of Fiduciary Duty

Customer alleges that the broker breached his duty (position of trust and confidence) to a client.

Negligence

A claim for negligence is that the broker failed to use reasonable diligence in handling the affairs of the customer, and did not act as a reasonable and prudent broker would have acted.

Selling Away

This often occurs in situations where the broker is not reporting a particular transaction to his or her employer.

Margin Violations

Failure to fully inform the customer of margin risks can result in liability for any losses caused as a result.

Life Insurance

Not unlike securities, the sale of life insurance generally imposes a duty of determining suitability on the selling agent. Most state insurance codes require "fair dealing" with customers and a duty of determining an appropriate recommendation. If the product is variable, it may be considered a security and is subject to NASD rules in addition to any state codes and regulations.

Commodities/Futures

Litigation and arbitration involving futures contracts, derivatives, and over-the-counter (OTC) trading

Subprime: When Fixed Income Becomes Risky (continued)

at an inappropriate time as well. This same play occurred in from 2000-2003 during the "tech bubble" when many brokers recommended this bottom fishing technique.

We have seen first hand that there has been no reasonable basis for expecting the financial services industry to be finished with its subprime mortgage write-downs. There simply has not been any reasonable basis for many investors to buy financial stocks during the past year and a half.

Investors who purchased fixed-income investments based on the premise of safety and

liquidity may have an unpleasant year ahead of them. The current credit crisis is now being felt by investors who relied on their advisors' recommendations. Unfortunately, many local investors, many of whom do not have a mortgage or their home, now own a share of the subprime debacle or, worse yet, have no access to their money. For investors who invested in "safe" bond funds that have since plummeted in value because of investments in mortgage-backed securities, many are making compelling cases that they were misled about the safety of the funds.

"This article was originally published in part in The Kansas City Star in 2008.

Other Cases of Note**Preferred Stock Complaints**

The current credit and subprime mortgage crisis has played a large part in the collapse of both Fannie Mae and Freddie Mac, two of the largest issuers of preferred stock. In turn, brokerage firms such as Merrill Lynch, Banc of America, Citigroup, Morgan Stanley and UBS sold massive amounts of these investments on unsuspecting investors looking for income-generating investments consistent with their risk profile.

However, many investors were led to believe these stocks were conservative and would provide steady income by way of above-average dividends. Many investors were told that the preferred stock issued by Fannie and Freddie were backed by the Government.

In July of 2008, the reality about Fannie Mae's actual financial condition came to light. Specifically, The New York Times said that the Government was considering taking over Fannie Mae and placing it in a conservatorship due to growing financial stress. As a result of this announcement, Fannie Mae's Series T Preferred Stock declined by almost 11%. One month later The Times stated that a bailout by the Government was imminent. Following this news, shares of Fannie Mae declined an additional 20%.

In September 2008, the Federal Housing Finance Agency ("FHFA") was appointed conservator of Fannie Mae by the Treasury Department. The Treasury Department's announcement of the takeover revealed Fannie Mae's inadequate capital management and significant capital inflation, thereby causing the price of Fannie Mae's Series T Preferred Stock to drop yet again. Overall, the value of Fannie Mae preferred stock fell by 88% to under \$2 per share in October 2008.

Unfortunately, investors have seen their retirement accounts devastated by the collapse of Fannie Mae and Freddie Mac, which resulted in their takeover by the Government. Brokers have a duty to recommend suitable investments, which includes diversifying their clients' portfolios out of their Fannie and Freddie investments as it became clear that the subprime crisis would have material effects on these two companies (both of which held huge amounts of those type of mortgages).

Lehman Brothers Principal Protected Notes and other Structured Products

Investors in Lehman Brothers structured products, namely so-called "principal protected notes," may be entitled to recover their investment losses. Many brokerage firms marketed and sold Lehman's principal protected notes as a product that would provide investors with "100 percent principal protection" and "uncapped appreciation potential." However, the notes actually exposed investors to far more risk than they agreed to. Many brokerage firms, including Merrill Lynch, UBS, Fidelity, and Wachovia, marketed and sold the notes to their own clients. In total, nearly \$70 billion in structured notes were sold to investors last year alone.

Featured in the Next Issue of MSLU...**Subprime, Part 2**

With market volatility at an all-time high, it is difficult for investors to understand the impact that the credit crisis and related problems will have on their investments. What was originally referred to as the bursting of a temporary housing bubble, everyday consumers and investors are now witnessing the trickle-down effect that this complicated story is having on their everyday lives. In the next issue we will explore the further effects that subprime investments have on mutual funds, bonds, CD rates, and other traditionally safe investments that the majority of retirees rely on to provide income. What we know so far is that fixed income may no longer be classified as a safe investment.

In future issues we will also address the increasing use and recommendation of complex estate planning by financial advisors (most of whom are not attorneys). These complex plans often do not provide any value added benefit for investors, but almost always result in the sale of high commission insurance products to the broker. In some cases, investors are completely divested of their money by way of charitable remainder trusts and other irrevocable instruments which can be problematic if the investor needs liquidity.

Did You Know?

The Kruske Law Firm also represents individual securities brokers and other securities industry employees who have claims against brokerage firms. Many employees working in the financial services sector and securities industry can face legal situations requiring experienced attorneys who can best represent their situations. Jeffrey Kruske has helped many industry professionals facing a variety of legal circumstances including Form U-5 defamation and expungement, employment disputes concerning compensation, disciplinary proceedings and representation at FINRA hearings.

Typical cases that an employee can bring are sexual harassment and employment discrimination (sex, age, race, disability) claims against their current and former employers. Securities rules allow these cases to be brought in a court as opposed to an arbitration forum. Former traders and brokers also bring cases against their former employers for failure to pay bonuses earned during the term of their employment. These cases include representing employees in claims for "fraudulent inducement" of their employment relationships. In these cases, the employees claim that their employers made false promises regarding the nature of the work which they were hired to do.

Other cases include lawsuits for Form U-5 defamation, which are claims against an employee's former securities brokerage firm for making false and defamatory statements on a Form U-5 filed by the firm with the FINRA. A brokerage firm is required to file a Form U-5 whenever an employee leaves the firm which discloses the circumstances surrounding the departure. If false and defamatory statements are made on the Form U-5 regarding the employee, the employee may have a claim for defamation.

Kruske Law Firm Selected to 2008 Super Lawyers

Jeffrey Kruske was selected for inclusion in the 2008 Missouri & Kansas *Super Lawyers* publication for securities litigation. *Super Lawyers* is a listing of outstanding lawyers from more than seventy practice areas who have attained a high degree of peer recognition and professional achievement. Only 5 percent of the total lawyers in the state are selected for inclusion in *Super Lawyers*.

CURRENT INVESTIGATIONS**Schwab YieldPlus Fund**

Charles Schwab & Co. marketed and sold the YieldPlus as a conservative bond fund. The fund was supposed to invest in "ultra" short-term, low-risk debt instruments that would not subject it to significant liquidity risks or fluctuations in share price. Contrary to its publicly-disclosed investment guidelines, Schwab caused the fund to invest heavily in high-risk, mortgage-backed instruments, including complex illiquid instruments. Approximately 40% of the Fund's assets were invested in complex mortgage-backed instruments known as Collateralized Mortgage Obligations ("CMOs").

These drastic, undisclosed changes in the Fund's investment profile significantly increased the risk to which their investors were exposed. Moreover, those changes directly contradicted representations in the Fund's Registration Statements and Prospectuses regarding the diversity, credit risk and liquidity of the fund's investments.

The fund now ranks dead last among ultra-short bond funds. As the market for the fund's long-term mortgage-backed securities evaporated, it was forced to sell those securities into an illiquid market, causing massive losses for clients.

Citigroup ASTA and MAT Funds

Citigroup is facing a number of lawsuits from investors who claim they are victims of deceptive marketing practices by brokers who sold ASTA & MAT funds as "safe" and "secure" alternatives to traditional bond funds. Citigroup's Smith Barney, presented the ASTA & MAT hedge funds as fixed income alternatives that would provide slightly higher returns with little or no volatility. Safety was a significant selling point in the marketing of ASTA & MAT investments.

In March 2008 Citigroup sent a letter to investors in the MAT Fund, advising them that because the credit crisis had spread into the municipal bond markets, the cash positions and net asset values of the MAT Fund had been severely affected. As a result, Citigroup would suspend income distributions in the fund indefinitely.

Many investors in the ASTA and MAT hedge funds were retirees. Since the funds' demise, these investors sustained significant financial losses. For many of them, the losses have compromised their futures. And while Citigroup may assign blame for the funds' downfall on unforeseen events in the municipal bond market, the reality is the funds were presented as low risk when in reality, they were anything but that.

Now, Citigroup apparently is creating a restructuring plan. The catch is that investors must first agree to forfeit any legal claims against the funds in addition to absorbing significant losses in their positions.

Fannie & Freddie Preferred Stock

Also featured in this edition of MSLU ("Other Cases of Note") Fannie Mae and Freddie Mac claims are on the rise. The collapse of the subprime mortgage market has led to the collapse of both Fannie Mae and Freddie Mac, two of the largest issuers of preferred stock. In turn, many large brokerage firms have unloaded the stock on unsuspecting investors looking for income-generating investments that are consistent with their risk profile.

Investors were led to believe these stocks were conservative and would provide regular dividend income. However, investors have seen their retirement accounts destroyed by the collapse of Fannie Mae and Freddie Mac. Brokers have a responsibility to only recommend investments that are in line with a client's risk tolerance and they should never concentrate a client to single investment, or very few investments.

While the subprime mortgage crisis was growing, brokers were concentrating their clients' holdings in these stocks, when they should have diversified their clients away from Fannie and Freddie.

For other current investigations, news, and prior newsletters, please visit www.kruskelaw.com.