

FINANCIAL POST

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RBC Near Resolving Credit Case with SEC

By Eoin Callan and Barbara Shecter

Royal Bank of Canada said it hoped to "reach a resolution soon" in a case being brought by the Securities Exchange Commission over its role in the collapse of the auction-rate securities (ARS) market that left many Americans unable to access savings they had set aside for short-term needs like college tuition and medical expenses.

A resolution with federal enforcement officials would make RBC one of the first banks in the country to be called to account for its conduct leading up to the credit crisis, which has helped drive the U. S. economy into the doldrums and threatens to drag down Canada.

The push to resolve the enforcement action being pursued by federal authorities comes amid mounting public anger in the United States over a US\$700-billion plan to buy up toxic assets in a bid to restore the financial health of the banking system.

The US\$330-billion auction-rate securities market froze in the spring, leaving customers of RBC and other banks facing waits of years or decades to access holdings they believed were liquid and similar to cash, according to the SEC.

"We proactively approached them to resolve their case with us two weeks ago," said an RBC spokesperson. "Like other participants in the ARS [market], we have been in discussions with the SEC and other regulators since April. We hope to reach a resolution soon."

It was unclear what form a resolution might take and whether recent settlements and enforcement actions involving federal and state regulators and U. S. and international banks would provide a reliable guide.

The outcome could include fines, civil or criminal charges, a settlement that would see money returned to some investors, or a combination of these.

An RBC spokesperson said the bank had initially pegged \$1-billion as the amount of its \$4.9-billion in estimated exposures it "would consider buying back from retail clients," but now expected that amount to be lower.

The comments from RBC follow disclosures about the case that appeared in yesterday's Financial Post. Officials at the regulator said they were actively pursuing a case against RBC after previous investigations found firms dealing in

auction-rate securities misled customers into believing the financial products were safe and highly liquid investments comparable to cash deposits.

A U. S. federal official said there had been a brief hiatus in enforcement actions amid the recent market panic that swept Wall Street, but authorities were redoubling their efforts after a bailout plan was proposed that leaves taxpayers on the hook for losses on complex securities that have gone bad.

It is not the first time RBC has come before the SEC in connection with its role in the auction rate securities market.

In 2006, the Canadian bank was ordered to pay a penalty of \$1.5-million after an investigation of RBC and more than a dozen other financial institutions alleged they had engaged in tactics including intervening in auctions by bidding for a firm's proprietary account to prevent failed auctions.

RBC and the 14 other banks including Bear Stearns and Co. Inc., Wachovia Capital Markets LLC and Citigroup Global Markets Inc. neither admitted nor denied the regulator's findings, but were censured and fined and agreed to abide in future by the SEC's rules

prohibiting "material misstatements and omissions in any offer or sale of securities."

RBC's prior run-in with regulators is likely to factor into negotiations and any financial penalties that might arise from the latest SEC action, according to lawyers who have worked in the regulator's enforcement division.

Jake Zamansky, now at Zamansky & Associates in New York, said the initial settlement would be considered "a warning shot to these firms that they have to really let investors know about the risks of those instruments."

Jacob Frenkel, a former SEC enforcement lawyer who is now a partner at Shulman, Rogers in Maryland, said:

"When the SEC comes back at a firm for repeat conduct, the expectations on a settlement are going to be more rigorous. I think we can expect a much larger financial settlement."

The regulator has left the door open for financial penalties in settlements this summer with Wachovia, Citigroup and UBS. The immediate focus of those settlements was for the banks to buy back billions of dollars of auction rate securities that were sold to investors.