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Principal-Protected Notes Not So Protected, FINRA Says

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Principal-Protected Notes are anything but protected FINRA says, and the SRO wants to make sure brokerages are making that clear to investors.

In a regulatory notice this month, FINRA warned firms offering structured products not to overstate their level of protection or their potential returns. FINRA credits the rise in popularity of principal-protected notes to the way the product is marketed as relatively safe. "Principal-protected notes sold to retail investors often have reassuring names that include some variant of 'principal protection,' 'capital guarantee,' 'absolute return,' 'minimum return' or similar terms. However, they are not without risk. Most importantly, the principal guarantee is subject to the creditworthiness of the guarantor," the note says.

The notice comes just two weeks after a FINRA arbitration panel awarded one investor \$200,000 after finding that her UBS broker inappropriately sold her risky Lehman Brothers Holdings Inc. principal-protected notes. New York-based securities lawyer **Jake Zamansky**, who represented

the investor, says UBS sold more than \$1 billion of these notes to retail investors, and that his client's award is the first arbitration ruling relating to them in the country.

"The potential implications of the arbitration panel's findings are significant. If the South Carolina ruling proves to be a bellwether, UBS's ultimate liability could be staggering, particularly given that the firm was forced to take a \$900 million writedown relating to its sale of auction rate securities. Though UBS was by far the biggest peddler of the Lehman notes, countless other Wall Street firms sold them as well as other structured notes, and they, too, may face significant liability," Zamansky writes on his blog.

UBS says it "is disappointed the arbitration panel in this case awarded the claimant any damages, even if it was only half the compensatory losses she was seeking. UBS maintains that any client losses were the direct result of the unexpected and unprecedented failure of Lehman Brothers, which affected all Lehman bondholders."

Steven Caruso, attorney with Maddox, Hargett & Caruso, told *The Wall Street Journal* that there are hundreds or thousands more arbitration cases that are expected to be filed in connection with Lehman principal-protected notes.

In July, the New Hampshire Bureau of Securities Regulation accused UBS of recommending unsuitable investments to customers who put their money into

complex securities underwritten by Lehman Brothers. The bureau alleges that UBS represented the securities as “safe” investments to clients, guaranteeing them “principal protection.”