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## ARS NEWSLETTER

April 18, 2008

- **Auction Rate Securities Are Not Considered “Cash Equivalents” Under Professional Accounting Standards**
- **Closed-End Funds Institute Limited Redemption Programs**

### **Auction Rate Securities Are Not Considered “Cash Equivalents” Under Professional Accounting Standards**

For years it was standard practice at many brokerage firms to market auction rate securities as “cash equivalents”. Investors were told that they could have access to their invested assets in as little as seven days. However, investors in many cases were never told that their ARS investments could become completely illiquid, and that in the event of an auction failure they could face the prospect of holding securities with perpetual maturity periods. A quick look at professional accounting standards reveals that auction rate securities clearly do not fall into the definition of “cash equivalents”, despite what was represented by the brokerage firms that sold them.

Two important organizations help define acceptable accounting practices in the United States: the Financial Accounting Standards Board (“FASB”) and the Governmental Accounting Standards Board (“GASB”). Both the FASB and GASB have published statements that define the term “cash equivalents” as “short-term, highly liquid investments” that are both a) “readily convertible to known amounts of cash,” and b) “so near to their maturity that they present insignificant risk of changes in value because of changes in interest rates.”<sup>1</sup> Both FASB and GASB have stated that generally, **only investments with original maturities of three months or less met this definition.**

Auction rate securities clearly do not fit within this definition. The underlying investments may have maturity periods of twenty years or more – and in the case of auction rate preferred shares, the maturity period may be perpetual. The major broker/dealers that actively marketed auction rate securities to the public have clearly had knowledge of these accounting standards for some time. Yet they ignored generally accepted principles of accounting and financial practices when they marketed auction rate products to their customers as “cash equivalents”.

### **Closed-End Funds Institute Limited Redemption Programs**

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<sup>1</sup> See, FASB Statement of Accounting Standards No. 95; GASB Statement No. 9.

Some closed-end funds have recently announced that they intend to redeem certain portions of their outstanding auction rate preferred shares (“ARPS”). For example, BlackRock Inc. announced this week that it expects to buy out \$1.9 billion of its funds' ARPS. While this may be welcome news for investors, it is just a small first step. The proposal by Blackrock covers only about 19% of the \$9.8 billion in ARPS it has issued. The vast majority of Blackrock ARPS investors will not be affected.

Nuveen has also announced similar buy-back plans. As with Blackrock, Nuveen's redemption plan will only cover a portion of its outstanding ARPS. The four Nuveen funds are the Multi-Strategy Income and Growth Fund, Real Estate Income Fund, Tax-Advantaged Total Return Strategy Fund, and Tax-Advantaged Dividend Growth Fund. The Tax-Advantaged Dividend Growth Fund will redeem all its \$36 million of auction-rate preferred shares. The other three funds will redeem shares on a pro rata basis. The Multi-Strategy Income and Growth Fund will redeem 64 percent of outstanding preferred shares. Real Estate Income Fund will redeem 68 percent, and Tax-Advantaged Total Return Strategy Fund will redeem 63 percent.

It should be noted that most redemptions are from taxable funds, specifically funds that have equity (stock market) exposure. It is our position that the closed-end fund companies are focusing their efforts on those funds in which it is no longer profitable to continue payments to preferred shareholders. Due to the downturn in the stock market, these taxable funds are losing money and paying interest to the preferred holders. Alternatively, the tax free funds, which are all bond funds, are still profitable. The bonds within these funds are likely yielding in excess of 6%, but they are only paying ARS holders less than 4% in most cases. Don't presume their actions are out of benevolence.

**Our firm is doing everything we can to help investors recover their money currently tied up in auction rate securities.** We will waive all legal fees if the issuer gives you your money back during the course of our representation of you. In addition, in the event the ARS market reverses itself, and you are able to sell your securities at par, we will also waive all legal fees. If you have not already, please review the following: [http://www.stockbrokerfraudblog.com/2008/02/how\\_wall\\_street\\_firms\\_convince.html](http://www.stockbrokerfraudblog.com/2008/02/how_wall_street_firms_convince.html)

Shepherd, Smith & Edwards, LLP is a law firm that handles securities cases for individuals and institutions nationwide. Our attorneys and staff have more than 100 years of brokerage and legal experience, placing us in a unique position of understanding both the law and the industry surrounding securities. If you have any questions, please contact us at (800) 259-9010 or email us at [arsinfo@sselaw.com](mailto:arsinfo@sselaw.com).

**Message from Kirk Smith and Sam Edwards:** *We have spoken at length with many of our newsletter subscribers over the past two months. We are happy to devote our time to fielding questions, providing insight and sometimes, just being a sympathetic ear for the venting of frustrations. We know this is a trying time for all ARS investors, and we are happy to continue our discourse with you. Feel free to give us a call if we can be of any service.*

*Thanks,*

*Kirk and Sam*