Wells Fargo reaches $6.5M settlement over sales of investments to municipalities

Company VP suspended and fined; 'broker-dealers must do their homework'

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August 14, 2012 3:41 pm ET

Wells Fargo & Co. will pay more than $6.5 million to settle charges from the Securities and Exchange Commission that it sold to local governments complex mortgage-backed securities that were too risky and hurt investors.

The settlement, announced Tuesday, also includes $65,000 in disgorgement and $16,571.96 in prejudgment interest. In addition, the agreement suspends former Wells Fargo vice president Shawn McMurtry from the industry for six months and forces him to pay a $25,000 penalty.

The SEC accused the firm of selling commercial paper comprised of mortgage-backed securities and collateralized-debt obligations to municipalities, nonprofit institutions and other customers without first understanding the instruments' potential volatility. The SEC said that Wells Fargo brokers pushed the products on investors who had limited appetite for risk.

The brokers, the SEC said, ignored private placement memoranda that explained the investments and instead based their sales pitches on flawed credit ratings. Three of the investments defaulted in 2007.

“Broker-dealers must do their homework before recommending complex investments to their customers,” Elaine Greenberg, chief of the SEC Division of Enforcement's Municipal Securities and Public Pensions Unit, said in a statement. “Municipalities and other nonprofit institutions were harmed because Wells Fargo abdicated its fundamental responsibility as a broker to have a reasonable basis for its investment recommendations to customers.”

In the settlement, Wells Fargo neither admitted nor denied the findings, which were based on securities sales from January to August 2007.

Michael Diver, an attorney for Mr. McMurtry, declined to comment.

The firm has taken “a number of remedial measures since 2007,” according to the SEC statement.

Wells Fargo said that it has moved on from the incident.

“These issues occurred more than five years ago and pertain to a part of the firm that was completely revamped after the merger with Wachovia [Corp.],” Elise Wilkinson, a Wells Fargo communications manager, wrote in an e-mail. “We are pleased to put this matter behind us.”

Problems in the municipal securities markets have been highlighted recently by an SEC report that called on Congress to give the commission more authority over the $3.7 trillion market to better protect investors. The SEC also has drafted a rule, mandated by the Dodd-Frank financial reform law, that would require muni advisers to register with the commission for the first time.

A bill in the House, written by Rep. Robert Dold, R-Ill., and one in the Senate, written by Sen. Patrick Toomey, R-Pa., would limit the scope of the new regulation by reducing the number of people who are defined as advisers.

In June, Stockton, Calif., filed for bankruptcy protection, while Jefferson County, Ala., declared the biggest muni bankruptcy in history last year.

The greater power that the SEC is seeking in muni markets has to do with municipalities' acting as issuers. The case against Wells Fargo involved a typical SEC action against a broker-dealer that marketed rather than underwrote securities.

“Here we're talking about the fundamental responsibility of a regulated entity, a broker-dealer,” Ms. Greenberg said in an interview.

“In this capacity, the SEC is protecting municipalities when they're in the role of investor,” she said. “[Wells Fargo] didn't have any idea of what it was they were selling.”