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July 17, 2009

**NOTICE OF INTENT TO COMMENCE ENFORCEMENT ACTION PURSUANT TO
SECTION 63(12) OF THE EXECUTIVE LAW AND SECTION 349 AND
SECTION 352, ET SEQ., OF THE GENERAL BUSINESS LAW**

VIA CERTIFIED MAIL AND OVERNIGHT DELIVERY

Carrie E. Dwyer, Esq.
Executive Vice President,
General Counsel and Corporate Secretary
The Charles Schwab Corporation
120 Kearny Street
San Francisco, California 94104

Re: Auction Rate Securities

Dear Ms. Dwyer:

You are hereby notified that it is the intention of the Office of the New York Attorney General to file fraud charges against Charles Schwab & Co., Inc. ("Schwab") pursuant to Executive Law Section 63(12), Article 22-A of the General Business Law ("GBL"), Section 349, and Article 23-A of the GBL, Section 352, *et seq.* (also known as the Martin Act), to enjoin unlawful acts and practices Schwab has engaged in and continues to engage in and to obtain injunctive relief, restitution, damages, civil penalties, costs, and such other relief as the Court may deem proper. Should we be unable to resolve our investigation forthwith, this Office is prepared to file legal action imminently.

Schwab's Fraudulent Practices In Connection with the Marketing and Sale of Auction Rate Securities

The Attorney General's investigation has revealed that Schwab engaged in repeated and persistent fraudulent, deceptive and illegal business practices by making material misrepresentations and omissions in connection with its sale of auction rate securities. Specifically, Schwab falsely marketed auction rate securities as safe, liquid, short-term investments that were similar to money market instruments.

Schwab brokers interviewed during the investigation have admitted that they consistently misrepresented auction rate securities as liquid, short-term investments suitable for cash management purposes or as good investments in which to temporarily "park" cash. Schwab

brokers have also admitted selling auction rate securities as money market fund equivalents. One broker admitted that Schwab customers “probably did not know that here is a product [auction rate securities] you might not be able to sell” because he and other Schwab representatives did not warn their customers. Other Schwab brokers admitted knowing little about auction rate securities. One such broker testified: “I don’t know what measuring scale you would want to use to assess my knowledge about auction rate securities ... but on whatever measuring scale my knowledge was pretty low.”

During the investigation, the Attorney General’s Office requested that Schwab produce audio recordings of conversations between members of Schwab’s fixed income sales force and Schwab’s customers. In response, Schwab produced only a fraction of the recordings subject to the Attorney General’s request. Schwab also informed the Attorney General that it could not locate many recordings subject to production, in apparent violation of Schwab’s recordkeeping obligations under federal securities law.

What audio recordings Schwab did produce confirm that Schwab brokers repeatedly misled investors about the risks of investing in auction rate securities. One Schwab broker described preferred auction rate securities to a consumer as a “short-term institutional holding instrument” that was particularly suitable for managing the customer’s cash balances:

If you need to have that access to them at any time, that’s a good place for those to be. You know if you think you might need to get into that money, that’s probably as good a place if not better than anywhere to leave them.

Another broker assured a consumer that she just needed to “call me ... and then the next month I’ll stop the auction and all the cash [invested in auction rate securities] will come back to your account.” Yet another broker represented that the hardest part of investing in an auction rate security “is getting into it. That is the tough part. Getting out of it is easy as just selling.” When one consumer asked if he could get out of his auction rate securities every 7 days a Schwab broker assured him “That’s right.”

The investigative record shows that Schwab repeatedly and persistently misled its customers by misrepresenting that they could sell their auction rate securities at each auction. These misrepresentations conveyed to Schwab’s customers a sense of confidence that their investments in auction rate securities would be safe and readily accessible to them in each auction cycle. Schwab’s persistent fraud was possible because Schwab failed to train or otherwise ensure that its brokers had a basic understanding of auction rate securities before they sold hundreds of millions of dollars of these securities to Schwab’s customers.

The investigation also revealed that, all the while, Schwab knew about liquidity risks associated with auction rate securities and increasing pressures in the auction rate securities market that compounded those risks. This knowledge resided not only with members of Schwab’s fixed income trading operation, which was responsible for managing and facilitating the auction rate securities business, and some members of its sales force, but also with senior business executives in the fixed income and investment management divisions of Schwab.

For instance, the record shows that Schwab knew about the possibility that auctions could fail and that the consequences of such failure would be a loss of liquidity until auctions cleared again, if they ever did. Schwab also knew that the major underwriter broker-dealers in the auction rate securities market were supporting the market with proprietary bids in order to keep auctions from failing, and could refrain from doing so at any time. Yet Schwab never disclosed these facts to its customers.

The record also shows that Schwab knew, or was reckless or negligent in not knowing, about rising problems in the auction rate securities market beginning in August 2007. Schwab received daily reports from the major underwriter broker-dealers, which showed that the inventories of those underwriter broker-dealers were increasing dramatically during the critical period between the final months of 2007 and the failure of the auction rate securities market. This information, indicating a progressive decline in demand for auction rate securities, was unavailable to the public. Most significantly, Schwab also knew about sporadic auction failures in the auction rate market as early as August 2007, when certain broker-dealers decided to stop submitting support bids. Some of these failures involved municipal auction rate securities, which were one the two main types of auction rate securities Schwab sold to its customers.

These incidents attracted the attention of senior Schwab managers. In response, one Schwab executive asked “[w]hat’s our exposure in this development, if any?” Another responded that there was a “brand risk of course” if Schwab customers “can’t get ... access to their funds.” When another auction failed in the Fall of 2007, one Schwab executive wrote:

This will definitely hit the Bond Buyer (maybe not until Friday) and it will likely hit the Journal as well. B[ank] of A[merica] has told us that they are not telling anyone today [that] there has been a failed auction – but it will likely come out tomorrow when the actual settlement occurs.

After the market collapsed in February 2008, Schwab executives expressed a desire for “keeping a low profile on this issue” and letting the big banks speak. While these Schwab employees did consider the public relations risks to Schwab, Schwab as a whole failed to grasp the growing risk of widespread auction failures, and the associated liquidity risk to Schwab’s customers. More importantly, Schwab failed to do anything to inform its customers or improve its disclosures.

On February 13, 2008, auctions for the vast majority of the auction rate securities that Schwab sold its customers failed when the wider market for auctions rate securities failed. As a result, Schwab customers who had purchased auction rate securities were, and many still are, left with no means to liquidate investments that Schwab offered and sold as safe and liquid. Schwab’s deceptive and fraudulent marketing and sales of auction rate securities is illegal conduct and violates New York law.

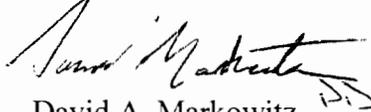
Schwab Must Take Immediate Action

The Office of the Attorney General remains open to resolving our investigation in a settled fashion, but stresses that any settlement must provide retail investors with the liquidity they were promised by Schwab.

Please be advised that, pursuant to Section 349(c) of the GBL, Schwab is hereby afforded the opportunity to show in writing, within five business days after receipt of this notice, why legal proceedings should not be instituted.

Thousands of consumers nationwide have been damaged due to Schwab's fraud. The Attorney General's office will continue to diligently work to achieve justice for these consumers.

Very truly yours,

A handwritten signature in black ink, appearing to read "David A. Markowitz", with a stylized flourish at the end.

David A. Markowitz
Chief, Investor Protection Bureau