The New York Times

FAIR GAME

‘100% Protected’ Isn’t as Safe as It Sounds

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Published: May 23, 2010

BROKERS selling complex securities that they once contended were safe and sound have saddled individual investors with billions in losses since the credit bubble burst. Remember auction-rate securities? Those were peddled to investors as just as good as cash — until they no longer were after that market seized up in 2008.

Questions about how Wall Street marketed yet another complex product, sold as solid and secure, are now emerging in investor arbitration cases. The instrument is named, inaptly as it turns out, “100 percent principal protected absolute return barrier notes.”

These securities are essentially zero-coupon notes sweetened by tying the return, in part, to the performance of an equity index, like the Standard & Poor’s 500 or the Russell 2000. The securities promise to return an investor’s principal, typically at the end of 18 months, with the added gain from the index’s performance if that index trades within a certain range. Brokerage firms often issued these securities.

For an investor in one of these notes to earn the return of the index as well as get the principal back, the index cannot fall 25.5 percent or more from its level at the date of issuance. Neither can it rise more than 27.5 percent above that level. If the index exceeds those levels during the holding period, the investors receive only their principal back.

Convoluted enough for you?

Yet, these securities appear to have been sold to conservative individuals whose financial market forays were usually limited to certificates of deposit. Many of these investors, to their great misfortune, bought principal-protected notes issued by Lehman Brothers. They are now worth pennies on the dollar.

CORINNE and Gregory Minasian were two of these investors who, at the suggestion of their broker at UBS, sunk almost $100,000 — more than half of their savings — into Lehman notes in early 2008. They lost everything and have filed an arbitration case against the firm to recover their losses.

The Minasians are a retired couple who live on Long Island. They contend that their UBS broker pushed the investment when one of their C.D.’s matured. The broker failed to explain the risks in the security, the Minasians said, and did not provide them with a prospectus. They did not even know their investment had been issued by Lehman Brothers until the firm collapsed.

“I am not a sophisticated investor,” said Mr. Minasian, a former engineer who is 68. “Many years ago I dabbled in the stock market, but I learned my lessons. Over the past 10 to 15 years my wife and I invested in C.D.’s.”

But that approach changed in January 2008, when, according to the Minasians, their UBS broker began calling with an investment idea — principal-protected notes. “We questioned him over and over,” Mr. Minasian said. “We initially told him we weren’t sure and that we wanted to think it over. Maybe the next day he called us and told us he was putting his father into the same notes and his father is very conservative.”

The Minasians said they decided to buy the instrument because they were assured by UBS, a financial adviser they had dealt with for years, that it was safe. The thing was called a "principal protected" note, after all.

Eight months later, Lehman went bankrupt. The note was virtually worthless.

Mrs. Minasian, 67, said she and her husband did not receive notice of problems with the investment until mid-October, when they received a form letter from UBS saying the value of their investment was "unavailable."

"I opened the letter and said, 'Why are we getting this?' " Mrs. Minasian said. "As I read it and we were wondering if it in fact did pertain to us, my heart sank. I almost fell on the floor."

UBS sold $1 billion of these notes to investors. Commissions were 1.75 percent, far higher than those generated on sales of C.D.'s. When Mr. Minasian asked about the commission, he says, his broker said there was none.

A spokeswoman for UBS, Karina Byrne, said, "UBS properly sold Lehman structured products to UBS clients, following all regulatory requirements, well-established sales practices and client disclosure guidelines." Client losses, she added, were the result of the "unprecedented failure" of Lehman Brothers.

Jacob H. Zamansky, the securities lawyer representing the Minasians, filed an arbitration claim against UBS on their behalf in late March. He says he has two dozen investors across the country telling similar stories of brokers recommending these securities without any explanation of their risks. Some UBS brokers are also telling him that they, too, feel they were misled about the risks in these securities.

"These are very opaque products that should not be sold to individual investors," Mr. Zamansky said. "Nobody understands what the product is."

In the Minasians' complaint, they also contend that UBS was in a position to have known that Lehman was in trouble and therefore should not have sold the securities to investors. According to the report of the Lehman bankruptcy examiner, UBS was one of the firms that helped Lehman conduct its now-infamous Repo 105 transactions, helping it mask the leverage it had on its books.

Ms. Byrne said that the examiner's report did not suggest that the banks that conducted those trades acted inappropriately.

As Lehman's cash crisis grew in the spring of 2008, it ramped up the issuance of these notes. But some brokers at UBS stopped selling Lehman Brothers notes at this time, Mr. Zamansky said.

He said some inside UBS seemed to recognize that Lehman was vulnerable. In March 2008, for example, after Bear Stearns collapsed, a UBS analyst wrote of the "harsh reality that some investors will think of Lehman as next on the list for the confidence/liquidity crisis."

The Minasians were not advised about any of these matters, Mr. Zamansky said. Now the retirees are unsecured creditors awaiting a minuscule payout in the Lehman bankruptcy.

"If the inner workings and true risks of these notes were ever honestly disclosed, no retail investor would buy one," Mr. Zamansky said. He has asked for a full recovery of the Minasians' losses from UBS.

THE Securities Litigation and Consulting Group, a financial economics consulting firm, analyzed 14 issues of these principal-protected notes and found that more than half of them carried a yield of less than 2 percent. More than half the time, the analysis concluded, "Investors would be better off investing in Treasury securities."

Add these securities to the growing pile of Wall Street inventions that benefit ... wait for it, wait for it ... Wall Street.