

**STATE OF ILLINOIS  
SECRETARY OF STATE  
SECURITIES DEPARTMENT**

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**IN THE MATTER OF:** )  
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**JP MORGAN CHASE & CO.,** )  
 ) **No. 08-00261**  
 )  
**Respondent.** )  
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**NOTICE OF HEARING**

**TO THE RESPONDENT:** JP Morgan Chase & Co.  
c/o its attorney  
Peter Bresnan, Esq.  
Simpson Thacher & Bartlett LLP  
601 Pennsylvania Avenue, N.W.  
North Building  
Washington, D.C. 20004

You are hereby notified in accordance with Sections 11.E and F of the Illinois Securities Law of 1953 [815 ILCS 5/11.E and F] (“the Act”) and 14 Ill. Adm. Code 130, subpart K, that a public hearing will be held at the Secretary of State’s office at the office of the Illinois Securities Department, 69 W. Washington Street, Suite 1220, in Chicago, Illinois 60602, on November 7, 2012 or as soon thereafter as possible before Soula Spyropoulos, or such other hearing officer who shall be presiding at that time.

Said hearing will be held to determine whether an Order shall be entered pursuant to Section 11.E of the Act sanctioning the Respondents and/or granting such other relief as may be authorized under the Act including, but not limited to, the imposition of a monetary fine in the maximum amount pursuant to Section 11.E of the Act, payable within ten (10) business days of the entry of the Order.

The grounds for this proposed action are as follows:

1. The Department has jurisdiction over this matter pursuant to the Act.
2. Auction rate securities are financial instruments that include auction preferred shares of closed-end funds, municipal auction rate bonds, and student loan-backed auction rate bonds (collectively referred to herein as “ARS”). While ARS are all long-term instruments, one

significant feature of ARS (which historically provided the potential for short-term liquidity) is the interest/dividend reset through periodic auctions. If an auction is successful (i.e., there are enough buyers for every ARS being offered for sale at the auction), investors are able to sell their ARS on a short-term basis. If, however, auctions “fail” (i.e., there are not enough buyers for every ARS being offered for sale), investors may be required to hold all or some of their ARS until the next successful auction in order to liquidate their funds.

**Marketing and Sales of ARS to Investors**

3. Although JP Morgan was aware of increasing strains in areas of the ARS market during the approximate six (6) months prior to the mass failure, JP Morgan failed to ensure that all of its registered representatives made appropriate disclosures to customers regarding the nature and risks of auction rate securities. Certain JP Morgan employees stated that auction rate securities were liquid, safe, short-term investments and did not highlight the risk that, in the event of a failed auction, the securities might become illiquid.

4. JP Morgan used the proprietary name, M-Stars or Municipal Short Term Auction Rate Securities, in marketing ARS. This could have led certain investors to conclude that ARS were short-term instruments. In fact, ARS were not simply “short-term” instruments. For example, certain student loan MSTARs had maturities in the year 2039 and full liquidity was only available at an auction if the auction was successful.

5. Starting in the fall of 2007, demand for certain auction rate securities continued to erode and JP Morgan’s auction rate securities inventory grew significantly. JP Morgan did not discuss the increasing risks of owning or purchasing auction rate securities with all of its customers.

6. In February of 2008, JP Morgan stopped uniformly supporting auctions for which it acted as the sole or lead broker. Without the benefit of support bids from broker-dealers, the auction rate securities market collapsed, leaving certain investors who had believed that these

securities were liquid, safe, short-term investments appropriate for managing short-term cash needs, holding long-term securities that could not be sold at par value.

7. JP Morgan engaged in practices prohibited by the Illinois Securities Law of 1953 [815 ILCS 5.1 *et. seq*] (the “Act”) by engaging in prohibited business practices of a dealer pursuant to Section 8.E(1)(e)(i) of the Act.

**Failure to Supervise Agents who Sold ARS**

8. JP Morgan did not provide all its sales or marketing staff with the training and information necessary to adequately explain these products or the mechanics of the auction process to their customers.

9. Not all of JP Morgan’s registered associated persons were adequately educated in the ARS products they were selling.

10. JP Morgan failed to reasonably supervise all its employees, by among other things:

a. failing to provide adequate training to all its registered agents regarding ARS by, among other things:

i failing to provide to all of its registered agents timely and comprehensive sales and marketing literature regarding ARS and the mechanics of the auction process;

ii failing to provide to all of its registered agents all pertinent information concerning the ARS product;

iii failing to provide to all of its registered agents all pertinent information regarding the state of the market prior to the mass auction failures in mid-February, 2008; and

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b. failing to review ARS transactions in accounts of certain customers who needed liquidity; and

c. failing to ensure that all its registered personnel were providing adequate information regarding ARS to its customer

11. By virtue of the forgoing, JP Morgan is subject to sanctions pursuant to Section 8.E(1)(e)(i) of the Act.


NOTICE: You are further notified that you are required pursuant to Section 130.1104 of the Rules and Regulations (14 Ill. Adm. Code 130)(the "Rules"), to file an answer to the allegations outlined above within thirty (30) days of the receipt of this Notice. A failure to file an answer within the prescribed time shall be construed as an admission of the allegations contained in the Notice of Hearing.

Furthermore, you may be represented by legal counsel; may present evidence; may cross-examine witnesses and otherwise participate. A failure to so appear shall constitute default, unless any Respondent has upon due notice moved for and obtained a continuance.

A copy of the Rules and Regulations promulgated under the Illinois Securities Law and pertaining to hearings held by the Office of the Secretary of State, Illinois Securities Department, are available at the Department's website at:  
<http://www.cyberdriveillinois.com/departments/securities/lawrules.html>, or on request.

Delivery of Notice to the designated representative of any Respondent constitutes service upon such Respondent.

Dated: This 21st day of September, 2012.

  
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JESSE WHITE  
Secretary of State  
State of Illinois

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Hearing Officer:  
Soula Spyropoulos  
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