

**UNITED STATES DISTRICT COURT  
EASTERN DISTRICT OF WISCONSIN**

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<b>UNITED STATES SECURITIES AND EXCHANGE COMMISSION,</b>	:	
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<b>Plaintiff,</b>	:	
	:	
<b>v.</b>	:	<b>Case No.</b>
	:	
<b>STIFEL, NICOLAUS &amp; CO., INC. and DAVID W. NOACK,</b>	:	<b>Jury Trial Demanded</b>
	:	
<b>Defendants.</b>	:	

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**COMPLAINT**

The United States Securities and Exchange Commission alleges as follows:

**Nature of the Action**

1. This case involves the fraudulent sale of complex financial instruments to five school districts in the State of Wisconsin (the “School Districts”) by Stifel, Nicolaus & Co., Inc. (“Stifel”) and David Noack, its former Senior Vice President.

2. Stifel and Noack recommended a series of investments to the School Districts as a means of addressing unfunded retiree benefits owed to current and former employees. Stifel and Noack encouraged the School Districts to invest in notes linked to the performance of synthetic collateralized debt obligations (“CDOs”) comprised of a portfolio of 100 or more credit default swaps on corporate bonds.

3. Stifel and Noack ultimately convinced the School Districts to invest tens of millions of dollars of their own funds – plus funds borrowed by specially-created trusts – for a total investment of \$200 million.

4. In effect, Stifel and Noack persuaded the School Districts essentially to insure the performance of a select group of corporate bonds, and do so with public funds.

5. Stifel and Noack induced the School Districts to invest in complex financial instruments through a series of falsehoods and misrepresentations. Stifel and Noack knew that the School Districts were risk-averse, and they knew that the preservation of capital was of paramount importance. They materially misled the School Districts about the risks of the investments, the likelihood of defaults, and the safety of their principal.

6. Stifel and Noack made sweeping assurances to the School Districts, representing that it would take “15 Enrons” – meaning a catastrophic, overnight collapse of 15 investment-grade companies – for the investments to fail. They represented that 30 of the 105 companies in the portfolio would have to go bankrupt, and that 100 of the top 800 companies in the world would have to go under, before the School Districts would suffer a loss of their principal. They represented that there would be breadlines, and that the country would have to suffer an economic collapse greater than the Great Depression, before the School Districts would lose their money. They represented that the investments were safe and similar to U.S. Treasuries.

7. All of those representations were untrue. Stifel and Noack materially misrepresented what it would take for the School Districts to suffer a complete loss. In reality, Stifel and Noack put the School Districts in jeopardy of losing their entire investments, based on much lower default rates than Stifel and Noack had represented.

8. Stifel and Noack also failed to disclose material facts. They did not disclose that certain CDO providers had expressed concerns about the investments – including concerns about heavy use of leverage, and concerns about selling this product to this type of investor – and declined to participate for those reasons. They also did not disclose that the portfolio in the first

transaction performed poorly from the outset, with a number of the credits suffering downgrades within weeks of closing.

9. The structure of the transactions was inconsistent with the conservative, risk-averse investment goals of the School Districts. The transactions involved substantial borrowing, both by the School Districts and by trusts created for the purpose of making the investments. Of the \$200 million invested in the so-called GOAL Program, \$198.7 million came from borrowed funds. The School Districts borrowed \$36 million of the \$37.3 million that they invested, and the trusts borrowed an additional \$162.7 million from a lender. The heavy use of leverage, combined with the tranche structure of the CDOs, exposed the School Districts to a heightened risk of catastrophic loss.

10. Stifel and Noack knowingly or recklessly recommended an unsuitable product that did not meet the investment needs of the School Districts. The School Districts had no prior experience investing in CDOs and related investments, and they were not the typical buyers of such complex financial products. Stifel and Noack knew, or were reckless in not knowing, that the School Districts lacked the requisite sophistication, capacity, and expertise to independently evaluate the risks of the products sold to them. They also knew that the School Districts looked to them for financial advice and relied on their recommendations. The School Districts placed their trust in Stifel and Noack, and that trust was misplaced.

11. In the end, the investments were a failure, and the School Districts suffered a complete loss. The School Districts lost tens of millions of dollars as a result of the fraud committed by Stifel and Noack.

12. Unlike their clients, Stifel and Noack profited from the GOAL Program. The Program generated significant fees for Stifel, and Noack received a substantial percentage of Stifel's fees.

13. By engaging in the conduct described above, Noack and Stifel violated Section 10(b) of the Securities Exchange Act of 1934 ("the Exchange Act"), 15 U.S.C. § 78j(b), and Rule 10b-5 thereunder, 17 C.F.R. § 240.10b-5, as well as Section 17(a) of the Securities Act of 1933 ("the Securities Act"), 15 U.S.C. § 77q(a). Stifel also violated Section 15(c)(1)(A) of the Exchange Act, 15 U.S.C. § 78o(c)(1)(A), and Noack aided and abetted Stifel's violations of Section 15(c)(1)(A).

#### **Jurisdiction and Venue**

14. The Court has jurisdiction over this action pursuant to Sections 20 and 22 of the Securities Act, 15 U.S.C. §§ 77t and 77v, and Sections 21 and 27 of the Exchange Act, 15 U.S.C. §§ 78u and 78aa. Defendants have, directly or indirectly, made use of the means and instrumentalities of interstate commerce, of the mails, or of the facilities of a national securities exchange in connection with the acts, practices and courses of business alleged in this Complaint.

15. Venue is proper in this judicial district pursuant to Section 22 of the Securities Act, 15 U.S.C. § 77v, and Section 27 of the Exchange Act, 15 U.S.C. § 78aa, because many of the acts, transactions and courses of business constituting the violations alleged in this Complaint occurred within the jurisdiction of the United States District Court for the Eastern District of Wisconsin.

### Defendants

16. **Stifel, Nicolaus & Co., Inc.** is a retail and institutional brokerage and investment banking firm based in St. Louis, Missouri. Stifel is registered with the Commission as a broker-dealer and investment adviser, and is the primary subsidiary of Stifel Financial Corp., a publicly-held company whose stock trades on the New York Stock Exchange.

17. **David W. Noack**, age 48, resides in Hartland, Wisconsin. During the period of time at issue in this matter, Noack was a Senior Vice President of Stifel and the co-head of its Milwaukee office. Noack worked for Stifel from 2000 to 2007, and he acted as an employee and representative of Stifel during that period. Stifel exercised power or control over Noack on a day-to-day basis.

### Other Relevant Entities

18. **School District of West Allis-West Milwaukee** (“West Allis-West Milwaukee”), **Kenosha School District No. 1** (“Kenosha”), **School District of Waukesha** (“Waukesha”), **Kimberly Area School District** (“Kimberly”), and **School District of Whitefish Bay** (“Whitefish Bay”) are school districts located in eastern Wisconsin. Each of the School Districts operates through, among others, a superintendent of schools, a business services department, and a school board made up of seven to nine district residents elected to a term of three years.

19. Each of the School Districts created a distinct OPEB trust (collectively, the “**OPEB trusts**” or the “**trusts**”) through which each of them invested.

20. **RBC Capital Markets Corp.** (“RBC Capital Markets”) was a Minnesota corporation, headquartered in New York, New York. It merged with and into another entity, RBC Dain Rauscher Inc., in 2008 and changed its name to RBC Capital Markets, LLC in 2010. During 2006, RBC Capital Markets was registered with the Commission as a broker-dealer and

as an investment adviser. RBC Capital Markets was a wholly-owned subsidiary of the Royal Bank of Canada.

21. **Royal Bank of Canada** (“RBC”) is a Canadian investment bank, and is the parent organization of RBC Capital Markets, LLC and Royal Bank of Canada Europe Limited. RBC and its affiliates created the investments sold to the OPEB trusts by RBC-controlled special purpose vehicles.

22. **Royal Bank of Canada Europe Limited** (“RBC Europe”) is a United Kingdom investment bank, and is a wholly-owned subsidiary of the Royal Bank of Canada. RBC Europe acted as the arranger of the special purpose vehicles that issued the credit-linked notes purchased by the OPEB trusts.

### **The Facts**

#### **The Origin of the GOAL Program**

23. In addition to pensions, the School Districts agreed to provide their employees other post-employment benefits, such as healthcare and life insurance. The commitments to provide Other Post-Employment Benefits are known in the industry as “OPEB” liabilities.

24. In June 2004, the Governmental Accounting Standards Board issued a new policy statement requiring government agencies to measure and report their OPEB liabilities in their financial statements, including the extent to which they were funded.

25. Up to that point, the School Districts had funded their OPEB liabilities from their general operating budgets as those liabilities came due. At that time, the School Districts had not yet funded future OPEB liabilities.

26. Stifel and Noack were aware of the OPEB liabilities of the School Districts in light of their longstanding relationship. Stifel and Noack had served as a financial advisor to each of the School Districts on other transactions.

27. Noack had a longstanding business relationship with each of the School Districts. Noack began working with West Allis-West Milwaukee in 2000-2001, and began working with Kenosha in 2004. Noack began working with Waukesha, Kimberly, and Whitefish Bay in the 1990s. He served as an investment banker or advisor to the School Districts on bond issuances and other financial matters.

28. Acting on behalf of Stifel, Noack frequently appeared at school board meetings to provide advice about debt programs, and had developed working relationships with members of the school boards. The School Districts had a pattern of following his advice.

29. Each of the five School Districts considered Noack to be their financial advisor, and they put their trust in him. Stifel and Noack knew that the School Districts relied upon them for financial advice.

30. To address the OPEB liabilities, Stifel and Noack created the Government Owned Life Insurance (“GOLI”) Program in late 2004 and early 2005. Under the GOLI Program, municipal clients would create an OPEB trust that would invest funds in life insurance policies on their employees. One of the five School Districts (Whitefish Bay) invested in the GOLI Program. Later, due to proposed legislation prohibiting such investments, Stifel and Noack stopped promoting the GOLI Program.

31. After the GOLI Program was abandoned, Stifel and Noack searched for a new investment vehicle to fund the OPEB liabilities of the School Districts. Stifel’s internal discussions included analysts from Stifel’s Milwaukee office, as well as Stifel’s Alternative

Spread Products desk in Baltimore, Maryland. The discussions included the possibility of using CDOs as an investment vehicle.

32. Noack contacted Depfa Bank about the possibility of serving as a lender for a new program. Depfa Bank expressed a preference for CDOs as the underlying collateral for the loans. After consulting with Depfa Bank, Stifel and Noack decided that synthetic CDOs would be the underlying investment in a new investment program.

33. In late 2005 to early 2006, Stifel and Noack created the Government OPEB Asset and Liability Program, also called the "GOAL Program." The GOAL Program envisioned that the School Districts would make investments through specially-created trusts to generate funds to pay OPEB liabilities.

34. Noack worked with others at Stifel on the GOAL Program. Stifel formed an internal working group to discuss various issues, and the group included Noack, Stifel's CEO, Stifel's CFO, members of Stifel's Alternative Spread Products trading desk, and several others.

35. Stifel's CEO was personally involved in all three investments made by the School Districts in June, September, and December, 2006. Noack reported directly to Stifel's CEO about the GOAL Program, and the CEO played a significant role in key decisions. Among other things, the CEO reduced the size of the June 2006 deal from \$136 million to \$25 million, contrary to Noack's wishes, and insisted that Stifel act as a placement agent rather than principal on the September and December 2006 deals.

### **Background of CDOs**

36. The centerpiece of the GOAL Program was CDOs. A collateralized debt obligation is a type of asset-backed security collateralized by a pool of fixed income assets, such as mortgage-backed securities or credit default swaps.

37. CDOs are often structured into a hierarchy of tranches, with each tranche representing a different level of risk and return. The lowest tranche typically absorbs the first losses in the portfolio until investments in that tranche are completely eliminated. At that point, the next tranche typically would begin absorbing losses, if any. The highest tranche traditionally would not suffer any losses until all of the lower tranches had suffered total losses. In certain CDOs, the tranches may overlap, so that a higher tranche would begin suffering losses before the lower tranche was completely wiped out.

38. The School Districts did not invest directly in CDOs, and neither did the OPEB trusts. Instead, the School Districts provided funding to the OPEB trusts, and the OPEB trusts invested in credit-linked notes issued by special purpose vehicles affiliated with RBC. The notes, in turn, were structured in a way to provide the economic equivalent of investing in a CDO tranche. That is, the notes paid an agreed-upon interest rate, but the payments and the return of principal depended on the performance of the CDO tranches in question. A failure of the CDO tranches would result in a loss of principal by the noteholder, and thus a loss by the School Districts.

39. A synthetic CDO is comprised of derivative instruments such as credit default swaps tied to the performance of bonds or other assets (unlike a cash CDO, which owns the bonds themselves). A credit default swap essentially allows one party to insure another party against the occurrence of an event in exchange for premium payments. Here, the OPEB trusts invested in notes tied to the performance of synthetic CDOs with a portfolio of 100 or more credit default swaps referencing corporate bond obligations. The credit default swaps essentially transferred the risk of default on the bonds to the OPEB trusts in exchange for the right to receive payments.

40. In essence, an investment in a tranche of a synthetic CDO functions like selling insurance on a portfolio of corporate bonds. The purchaser receives payments at an agreed-upon rate, as long as the losses within the underlying corporate credit portfolio do not reach an agreed-upon level.

41. If losses reach agreed-upon benchmarks, the investments in that CDO tranche are eroded or, potentially, wiped out. When losses reach an “attachment” level, the investor begins to lose its principal. When losses reach a “detachment” level, the investor loses its entire investment. For example, if an investment had an attachment point of 4.50% and a detachment point of 5.50%, the investor would begin to lose principal if losses in the portfolio reached 4.50%, and would lose all of its principal if losses in the portfolio reached 5.50%. The percentage reflects both the occurrence and the magnitude of a default. So, in a portfolio of 100 credits, a single default that suffers a complete loss is treated as 1%, and the same is true of two defaults where investors recover 50% after the default (or four defaults with a 75% recovery, and so on). Here, in the three deals with the School Districts, the attachment points were approximately 3.95%, 4.50%, and 4.60%, respectively, and the detachment points were approximately 4.95%, 5.50%, and 5.60%, respectively. So, in the first deal, the investment would not begin to lose principal until losses in the portfolio reached 3.95%, but the investment would be wiped out if losses in the portfolio reached 4.95%. That is, there was only a 1% difference between a complete recovery and a complete failure.

42. CDOs can be either “managed” or “static.” A managed CDO has a portfolio manager that typically selects the initial portfolio and manages the portfolio of credit default swaps, with the ability to trade certain credits out of the portfolio for new credits. A static CDO contains a fixed portfolio of credit default swaps that remain constant and cannot be changed

after consummation of the deal. Here, the OPEB trusts purchased notes tied to managed CDOs, meaning that the portfolio manager had the ability to change the credits in the portfolio, subject to available resources.

43. During the period in question, rating agencies often rated the tranches of CDOs. Credit-linked notes tied to CDO tranches were rated as well. Here, the OPEB trusts invested in notes with a rating of AA-. The notes, in turn, were tied to specific CDO tranches.

44. The tranches of CDOs can be composed of assets with a variety of credit ratings. That is, the rating of a tranche is not necessarily the same – and often is not the same – as the rating of the underlying assets in the portfolio. Here, at the time of the investments, the CDO tranches in question were composed of credit default swaps referencing corporate bonds with ratings ranging from AAA to BBB- in the first two deals, and from AAA to B+ in the third deal.

#### **The Lack of Familiarity with CDOs**

45. In 2006, typical purchasers of CDOs included hedge funds, insurance companies, investment banks, and other highly sophisticated financial institutions. According to an email from Stifel’s CEO to Noack, the “buyers for this product are often hedge funds, banks or insurance companies with billions in fixed income assets.” The typical buyers tended to be highly sophisticated in light of the complexities – and risks – of the investments. Here, Stifel and Noack sold notes tied to CDOs to a very different type of buyer: school districts.

46. The School Districts had no prior experience investing in CDOs, or in instruments tied to CDOs. In fact, before 2006, the School Districts had done relatively little investing, apart from cash-equivalent instruments and certificates of deposit. Compared to the typical buyers of instruments tied to CDOs, the School Districts were relatively unsophisticated investors.

47. Significant financial decisions by each School District required the approval of the school board. Almost all of the school board members lacked a background in structured finance, and had little or no training or experience with CDOs and credit default swaps.

48. Stifel and Noack knew the investment history of each of the School Districts. Noack, in particular, had years of first-hand experience with the School Districts, and was well-aware of their investing history and their relative lack of sophistication. Stifel and Noack knew that the School Districts had no prior experience investing in CDOs, or in instruments tied to CDOs. They knew that most of the school board members were unfamiliar with CDOs and credit default swaps. They knew that the School Districts were not the typical investors in instruments tied to CDOs.

49. CDOs were new to Noack as well. Before late 2005 or early 2006, Noack had no prior experience with CDOs, and he had little or no understanding of how CDOs functioned. He had never sold a product tied to CDOs to any customer. Indeed, Noack had never even heard of CDOs before considering them for the GOAL Program.

50. Because he lacked expertise in CDOs, Noack turned to others at Stifel to learn more about them. In March, 2006 – after he had begun promoting the GOAL Program to the School Districts – Noack traveled to Stifel’s Baltimore office to learn more about CDOs.

51. Stifel knew that Noack had little or no experience with CDOs, and had a limited understanding of their risks. For example, on June 1, 2006 – shortly before the first investment by one of the School Districts – Stifel’s head of Fixed Income sent an email to Stifel’s CEO. He wrote: “I do want you to consider the fact that Dave [Noack] was (and to a certain extent, still is) relatively ignorant about the nuances of CDOs . . . .”

52. Despite his lack of experience with CDOs, Noack recommended that the School Districts invest in notes tied to CDOs. Stifel knowingly allowed Noack to be the point person and, with limited exceptions, the sole Stifel representative when promoting the investments to the School Districts, despite his lack of experience and his limited understanding of CDOs.

53. Stifel had employees with greater expertise in CDOs than Noack, including individuals who worked on the Alternative Spread Products desk in Baltimore. Yet Stifel never sent a CDO expert to accompany Noack when explaining CDOs and marketing the GOAL Program to the School Districts. In fact, after an internal dispute about how to allocate fees between Noack and other Stifel employees, the Stifel employees with CDO expertise became less involved in the GOAL Program. Noack forged ahead without them.

54. Stifel and Noack viewed the OPEB liabilities of the School Districts as a significant business opportunity. They wanted to implement the GOAL Program quickly in order to gain an advantage over their competitors. They also believed that expanding the GOAL Program beyond Wisconsin could be highly profitable, given the size of OPEB liabilities facing municipalities nationwide. Noack had plans to expand the GOAL Program nationwide, and reap substantial profits in the process.

### **The Structure of the GOAL Program**

55. The structure of the GOAL Program was more complicated than any prior investments by the School Districts. The design required the creation and funding of trusts, followed by the purchase of notes from a Cayman-Islands-based special purpose vehicle tied to CDOs with a portfolio of credit default swaps on corporate bonds.

56. The GOAL Program involved the transfer of funds from the School Districts to specially-created OPEB trusts. The OPEB trusts also borrowed funds from Depfa Bank, the lender for the investments in the GOAL Program.

57. Taken together, the funds from the School Districts and from Depfa Bank provided the capital for purchasing the credit-linked notes. The OPEB trusts used the funds to purchase credit-linked notes from an RBC-affiliated special purpose vehicle.

58. The notes were linked to the performance of tranches of CDOs with portfolios of credit default swaps. The credit default swaps, in turn, were tied to the performance of 100 or more corporate bonds. In effect, the success or failure of the investments depended on the performance of a select group of corporate bonds.

59. A key feature of the GOAL Program was its use of leverage, that is, the borrowing of most of the funds by the trusts from Depfa Bank. Of the \$200 million invested in the Program, the School Districts contributed approximately \$37.3 million, and Depfa Bank contributed approximately \$162.7 million, to the trusts. The notes from the special purpose vehicles served as collateral for the loans from Depfa Bank.

60. The use of leverage significantly changed the risk/reward potential of the investments. The borrowed funds from Depfa Bank increased the size of the investments, thus creating the potential for larger returns – or larger losses. If the investments performed well, the School Districts would have reaped greater returns by virtue of the borrowing. But if the investments performed poorly, then the School Districts would lose their contributions at an accelerated rate through the use of leverage. The School Districts stood first in line – that is, ahead of Depfa Bank – for any losses by the OPEB trusts.

61. The significant use of leverage thus posed risks for the School Districts. The larger the amount of the borrowing, the greater the impact of the losses in the portfolio.

62. The borrowing costs also created pressure on Stifel and Noack to seek investment assets with the highest yields. The GOAL Program could achieve the desired returns only if the yield on the investments substantially exceeded the borrowing costs. For example, traditional investments in bonds rated AA- did not yield the necessary returns. So, instead of a direct purchase of bonds rated AA-, Stifel and Noack recommended investments in credit-linked notes rated AA- that referenced synthetic CDOs. Despite the “AA-” rating, the notes offered yields more closely correlated with bonds rated BBB or BB. In short, the notes rated AA- offered higher yields – and came with higher risks – than bonds rated AA-.

63. Similarly, the borrowing costs created pressure to find the highest-yielding CDO investment with a rating of AA-. Different CDO providers offered varying yields on different CDO tranches rated AA-, due in part to differences in the underlying portfolios. That is, not all CDO tranches rated AA- offered the same yield. Here, RBC Capital Markets was selected in part because it offered CDO tranches with relatively high yields.

64. The tranche structure also magnified potential losses. If the School Districts had purchased a portfolio of bonds rated AA-, then portfolio losses of 5% to 6% would have led to investment losses by the School Districts of 5% to 6%. But here, the CDO tranche structure meant that portfolio losses of only 5% to 6% (*i.e.*, the detachment point) resulted in a 100% investment loss for the School Districts. The CDO tranche structure protected against losses up to the attachment point, but quickly accelerated losses up to the detachment point, when the investment was wiped out. The CDO tranche structure magnified losses in the portfolio and heightened the risk of a complete loss of the investments by the School Districts. The CDO

tranche structure partly explains why the credit-linked notes rated AA- offered higher yields than bonds rated AA-, and offered higher yields than the same portfolio of credit default swaps without a tranche structure. The tranche structure offered higher returns, but came with added risks.

65. By encouraging borrowing to purchase notes tied to CDOs, Stifel and Noack thus encouraged the School Districts to leverage a subordinated product. The trusts invested in notes that would suffer a complete loss if losses in the portfolio reached only 5% to 6%, and they did so primarily with borrowed funds.

66. The GOAL Program also posed mark-to-market risk. The credit-linked notes from the special purpose vehicles served as collateral for the loans from Depfa Bank to the trusts, providing an average over-collateralization of 120%. The School Districts provided additional credit support through a “Moral Obligation Contribution Agreement.” The School Districts assumed a “moral obligation” to contribute additional funds to their OPEB trusts if the collateralization fell below 101%, that is, if the value of the synthetic CDOs fell below 101% of the value of the Depfa Bank loans.

67. Under the loan agreements, the trusts could experience negative consequences if the School Districts elected not to contribute additional capital. If the value of the assets fell below 100% of the Depfa Bank loan balance, and if the School Districts failed to provide additional capital, then the interest rates increased on the loans from Depfa Bank to the trusts. If the value of the assets fell below 95% of the loan balance, then Depfa Bank could redeem the notes on its loans to the trusts and seize the credit-linked notes as collateral. If this were to occur, the credit-linked notes could be sold at a value that would result in a total loss of the contributions by the School Districts.

68. The mark-to-market risk thus posed a significant vulnerability to the School Districts. If the value of the collateral declined even temporarily, then the School Districts would have to make a difficult choice. They would have to choose between contributing additional funds to the trusts, or allowing interest rates to rise and thus risk the erosion or total loss of their investments. A failure to honor the “moral obligation” to contribute additional funds also could impair the credit ratings of the School Districts, and thus impair their future ability to raise funds.

69. In sharp contrast, the structure of the GOAL Program posed opportunities, not risks, for Stifel and Noack. The structure of the GOAL Program generated fees for Stifel on several fronts, including the issuances of bonds by three of the School Districts, the issuances of notes by Depfa Bank, and the purchases of credit-linked notes by the OPEB trusts. In particular, the use of leverage created the opportunity for Stifel to earn significant fees: the higher the borrowing, the greater the fees. Like Stifel, Noack stood to profit from the fees as well. His compensation included a percentage of the fees that Stifel obtained from the GOAL Program.

#### **The Misrepresentations by Stifel and Noack**

70. Stifel and Noack convinced the School Districts to invest tens of millions of dollars of public funds in the GOAL Program. They did so through a series of misrepresentations, omissions, and outright falsehoods.

71. Acting on behalf of Stifel, Noack made a number of presentations to the School Districts about the GOAL Program. He recommended investments in the GOAL Program during school board meetings, meetings with the business managers of the School Districts, and meetings with members of the school board finance committees. He sent presentation materials

by email, and often spoke with representatives over the phone about the GOAL Program. Some of the meetings were recorded.

72. Noack repeatedly focused his sales pitch on one of the most important concerns of the School Districts: the safety of the investments. He gave materially false information to the School Districts about one of the issues that mattered the most.

73. Noack represented that the CDO investments were “Treasury-like,” and he claimed that they were virtually risk-free. For example, before the first deal, Noack told West Allis-West Milwaukee to think of these investments like Treasury bonds due to the quality of the companies in the portfolio. He represented that only Treasury securities would be a safer investment. Similarly, Noack represented to Waukesha that the CDO investments were similar to Treasury securities because the portfolio was comprised of AAA and AA corporate debt.

74. Those representations were materially false. The investments in the GOAL Program involved significantly more risk than investing in U.S. Treasuries.

75. Noack represented that 30 of the 105 companies in the portfolio would have to default before the School Districts would begin to lose their principal. For example, Noack made that representation to Waukesha, among possible others.

76. That representation was materially false. The attachment point in each of the three deals was below 5%. By design, the investments involved risk that the School Districts would begin to lose their principal if far fewer than 30 companies defaulted. That risk later materialized. The number of defaults that caused the School Districts to lose principal for the June, September, and December 2006 deals included 8 defaults out of 105 companies in the first deal, 8 defaults out of 100 companies in the second deal, and 10 defaults out of 140 companies in the third deal.

77. Noack represented that it would take “15 Enrons” for the School Districts to lose money. For example, at a meeting of the school board of Whitefish Bay on November 15, 2006, Noack stated: “And it gives added comfort that, you know, it takes 15 defaults for us to start losing money and we have somebody watching over every company, every day, for seven years, and if it starts to look like it’s going that way, they get out of it. The only way – the real – you need 15 Enrons. You need something to happen that big overnight.” The audio was recorded.

78. That representation was materially false. It did not require 15 companies to completely collapse before the investments would fail. The detachment points in each deal were less than 6%, meaning that fewer than 15 defaults could cause (and did cause) the School Districts to lose their investments.

79. Noack represented that it would take 8.5 times historically normal default levels for the School Districts to lose money, which only happened during the Great Depression. For example, Noack made that representation to the School Districts before the second deal.

80. That representation was materially false. The GOAL Program put the School Districts at risk, even if default levels did not reach 8.5 times historically normal levels. It did not require the Great Depression for the investments to fail.

81. Noack represented that there had not been a default since Enron in 2000. For example, he made that representation to Kimberly, among possible others.

82. That representation was materially false. There had, in fact, been defaults since Enron in 2000.

83. Noack represented to Whitefish Bay during a meeting on November 15, 2006 that West Allis-West Milwaukee had already done two deals, and “if there is a hiccup in one of the investments, we would slow down.” The audio was recorded.

84. That representation was materially false. Stifel and Noack knew that the first investment had performed poorly within weeks of closing. In fact, Stifel and Noack asked RBC Capital Markets to repurchase the notes from the first investment. Yet Stifel and Noack recommended the second and third deals to the School Districts, without disclosing the poor performance.

85. Noack represented that the third deal would involve an investment in only investment-grade companies. During a meeting of the school board of Waukesha on November 27, 2006, which was videotaped, Noack stated to the school board: “[A]gain, we’re only investing in higher grade companies. If you look at the balance sheets of investment grade companies in the world today, which is 805, they’re doing better than ever.” Noack later said at that same meeting: “[T]he odds of, again, it takes twenty out of these hundred companies to default before it gets to your AA level.”

86. That representation was materially false. The third transaction involved credits that were not investment grade. Also, the third deal involved risk that the School Districts could lose their principal if fewer than 20 companies defaulted. The attachment point in the third deal was less than 5%, and the detachment point was less than 6%. The investment in the third deal ultimately failed when 10 out of 140 companies defaulted, far less than the 20% default rate that Noack had represented.

87. Noack represented that there was a short-term mark-to-market risk, but that it was not a long-term risk because the School Districts would still get their money back after seven years. For example, he made that representation to Kenosha, among possible others.

88. That representation was materially false. The mark-to-market risk created a very real risk that the School Districts would not receive a return of their principal, even if the underlying investments ultimately recovered.

89. Noack represented that, of the top 800 companies in the world, 100 of them would have to go under before the School Districts would suffer any principal loss. For example, he made that representation to Kenosha, among possible others.

90. That representation was materially false. The School Districts suffered a loss of their investments, even though far fewer than 100 of the top 800 companies in the world collapsed.

91. Noack represented that, if the investments failed, they would all be in bread lines together. For example, he made that representation to Waukesha, among possible others.

92. That representation was materially false. The investments collapsed, even in the absence of breadlines. There was a risk that the investments would fail, even without an economic calamity of the magnitude of the Great Depression. For example, according to research from Moody's, certain CDOs with a AA rating issued in the United States from 1993 to 2003 became impaired.

93. Noack represented that the country would have to fall further into financial trouble than the Great Depression before the investments would be affected. But even in that scenario, according to Noack, the School Districts would get their principal back after seven years and did not have to worry about losing principal. For example, he made that representation to West Allis-West Milwaukee. He similarly told other School Districts that it would take a Great Depression for the investments to fail.

94. That representation was materially false. The investments failed, even though the recent economic downturn was not as severe as the Great Depression. Other CDOs with a AA rating became impaired during 1993 to 2003, without a Great Depression.

95. Noack represented that if any of the highly-rated portfolio credits struggled, the portfolio manager would simply replace that credit with another stronger credit to maintain the AA rating. For example, he made that representation to Whitefish Bay and to Kimberly, among possible others.

96. That representation was materially false and misleading. In reality, the portfolio manager had limited resources to swap credits, and an exchange of credits generated additional costs because struggling portfolio credits could only be sold at reduced prices.

97. Noack misrepresented the initial performance of the first investment. On or about August 14, 2006, Noack attended a West Allis-West Milwaukee school board meeting to propose an additional investment in the GOAL Program. A school board member asked Noack how the first investment was performing. Noack responded that the investment was “on course.”

98. That representation was materially false and misleading, and omitted material information necessary to make it not misleading. At the time, Stifel and Noack were aware of a surprising number of downgrades within the CDO portfolio, as well as numerous substitutions by the portfolio manager to prevent the notes from being placed on negative ratings watch. Approximately 10 days before making that statement, Noack asked RBC Capital Markets to repurchase the notes and complete a new deal on more conservative terms.

99. On November 15, 2006, Stifel and Noack told Whitefish Bay’s school board that they had completed two deals already with West Allis-West Milwaukee. He stated: “So, we are phasing it in and if there is a hiccup in one of the investments, we would slow down, Okay?”

100. That representation was materially false and misleading, and omitted material information necessary to make it not misleading. Stifel and Noack were aware of a surprising number of downgrades within the CDO portfolio in the first transaction.

101. Noack acted on behalf of Stifel when he made each of the representations to the School Districts.

102. All of these statements by Stifel and Noack were materially false and misleading. Noack either knew that his representations were inaccurate, or acted recklessly by making representations without a factual foundation. They overstated the safety of the investments, and gave the School Districts a false sense of security. The School Districts viewed the safety of their investments as one of the most critical factors in their decision-making. Stifel and Noack provided them with misinformation on an issue of primary importance.

103. In an affidavit executed in 2008, Noack admitted under oath that he had made statements and representations to the School Districts to persuade them to enter into the CDO transactions. He stated under oath that he had no reason to dispute that he had made statements to the School Districts such as “[i]t takes 20 out of these 100 companies to default before it gets to your AA level,” and “[t]here would need to be ‘15 Enrons’ before you would be impacted,” and others like them. Noack further admitted that certain of his statements to the School Districts were inaccurate.

104. In addition to misrepresentations, Stifel and Noack also failed to disclose material information to some or all of the School Districts.

105. Stifel and Noack did not disclose to each of the School Districts that the tranche structure of the CDO investments posed special risks.

106. Stifel and Noack did not disclose to each of the School Districts that they could lose their entire investment if only a fraction of the portfolio defaulted.

107. Stifel and Noack did not disclose to each of the School Districts that several potential CDO providers had declined to participate in the GOAL Program due to concerns about the proposed investments.

108. Stifel and Noack did not disclose to each of the School Districts that the portfolio in the first investment had performed poorly from the outset, with an unusually large number of credits downgraded or placed on negative credit watch.

109. Stifel and Noack did not disclose to each of the School Districts that the portfolio manager had a limited ability to protect the portfolio from poorly performing credits.

110. Stifel and Noack did not disclose to each of the School Districts that a failure to honor the moral obligation with Depfa Bank could have collateral consequences, such as an adverse impact on the credit ratings of the School Districts. In fact, Stifel and Noack stressed that the moral obligation had “no teeth.”

111. Stifel and Noack did not disclose to each of the School Districts that Noack had little or no experience with, and a limited understanding of, CDOs.

### **The First Investment**

112. Stifel and Noack succeeded in convincing the School Districts to entrust public funds in the GOAL Program. Collectively, the School Districts made three investments through the GOAL Program from June to December, 2006, investing \$37.3 million of public funds. Using those funds, and \$162.7 million in loans from Depfa Bank, the OPEB trusts invested \$200 million in credit-linked notes. Stifel and Noack recommended each of the investments to the School Districts.

113. The first transaction consisted of an investment by an OPEB trust created by the school district of West Allis-West Milwaukee. The school district of West Allis-West Milwaukee created an OPEB trust (“WAWM’s OPEB trust”) for the sole purpose of participating in the GOAL Program, and funded that trust shortly before the transaction closed.

114. On June 27, 2006, WAWM’s OPEB trust purchased Tribune Limited Series 30 Floating Rate Credit Linked Secured Notes due 2013 (the “Tribune 30 Notes”). The investment in the Tribune 30 Notes by WAWM’s OPEB trust totaled \$25 million. Of the \$25 million, approximately \$2.3 million came from the school district of West Allis-West Milwaukee, and approximately \$22.7 million came from Depfa Bank. West Allis-West Milwaukee borrowed the \$2.3 million in a public note offering to obtain its contribution to the GOAL Program. Thus, the entire \$25 million investment consisted of borrowed funds.

115. WAWM’s OPEB trust purchased the Tribune 30 Notes for \$25 million from Stifel. That is, Stifel received \$25 million from WAWM’s OPEB trust by selling the Tribune 30 Notes. Stifel, in turn, had purchased the notes from RBC or an affiliated entity at a discount.

116. At the time of issuance, the Tribune 30 Notes offered yields of three-month LIBOR plus 120 basis points, and had a duration of seven years.

117. The Tribune 30 Notes were linked to the performance of a CDO tranche with an underlying portfolio of credit default swaps on corporate bonds. The Tribune 30 Notes had a rating of AA-.

118. The attachment point on the Tribune 30 Notes was 3.95%, and the detachment point was 4.95%. That is, WAWM’s OPEB trust would begin losing principal if losses in the portfolio reached 3.95%, and would lose its entire investment if losses in the portfolio reached 4.95%.

### **The Red Flags Before the First Investment**

119. Stifel and Noack were aware of red flags before the closing of the first transaction.

120. In March, 2006, during a meeting with Noack and other Stifel employees, Stifel's Director of Investment Banking questioned the validity of the ratings assigned to the CDOs by rating agencies. Stifel and Noack did not share that concern with the School Districts.

121. In March, 2006, Stifel and Noack explored the possibility of retaining an independent third-party to evaluate the portfolio of assets tied to the Tribune 30 Notes. Yet no such evaluation took place before the first transaction. Stifel and Noack ultimately went forward and sold the Tribune 30 Notes to WAWM's OPEB trust, without receiving any assessment of the assets in the portfolio.

122. RBC Capital Markets discussed and debated the structure of the first transaction with Stifel and Noack. They disagreed about which party would serve as the principal on the transaction. RBC Capital Markets and Stifel shared something in common: they did not want to sell directly to the School Districts. Instead, each of them wanted the other entity to do so.

123. RBC Capital Markets advised Stifel that it would not sell directly to the School Districts in the first deal because it did not want to bear responsibility for determining the suitability of the investments for the School Districts. Stifel's CEO told RBC Capital Markets that he wanted RBC Capital Markets to act as principal because he wanted them "in the boat" with Stifel.

124. RBC Capital Markets and Stifel ultimately agreed that Stifel would purchase the Tribune 30 Notes from RBC Capital Markets at less than par, and resell the notes to WAWM's OPEB trust at par, and keep the difference as its transaction fee.

125. The agreement between RBC Capital Markets and Stifel contributed to a significant decrease in the size of the first investment. Stifel and Noack originally projected that the transaction would total \$136 million. The size of the first transaction fell from \$136 million to \$25 million in part because Stifel was unwilling to serve as principal for a \$136 million investment by West Allis-West Milwaukee. Stifel and Noack did not disclose to West Allis-West Milwaukee that RBC Capital Markets had refused to serve as principal on the transaction.

126. Stifel and Noack did not perform any due diligence on the particulars of the Tribune 30 Notes, and did not investigate its underlying portfolio of credits. On June 7, 2006 – just twenty days before closing – Stifel’s CEO stated to Noack: “We have done very little due diligence on this structure and would to [sic] need to know alot [sic] more” before Stifel could act as principal.

127. Despite the lack of due diligence on the underlying portfolio, Stifel sold the Tribune 30 Notes to an OPEB trust created by West Allis-West Milwaukee for \$25 million.

### **The Red Flags After the First Investment**

128. After the first investment, Stifel and Noack arranged a meeting in Wisconsin for July 26, 2006 between representatives of the School Districts and potential CDO providers. He invited a number of firms, including RBC Capital Markets, to attend and present information about their synthetic CDO products. Several of the firms declined the invitation.

129. An employee of one of the firms explained to Stifel and Noack that the firm could not get comfortable selling this product to the School Districts. The individual explained that the firm had sold such products only to “qualified institutional buyers,” meaning in essence highly sophisticated institutions with a significant amount of investment holdings.

130. Another potential CDO provider declined to participate in the GOAL Program. Noack requested an explanation in an email dated July 20, 2006, with the avowed goal of sharing that explanation with the School Districts: “Please let me know the reasons for passing on the opportunity so that I can relay that to my clients next Wednesday during your time slot.”

131. The potential CDO provider subsequently informed Stifel and Noack that it was uncomfortable with the large amount of leverage in the GOAL Program.

132. Stifel and Noack did not share that concern with the School Districts. Stifel and Noack did not disclose to the School Districts that a potential CDO provider had refused to participate in the GOAL Program because it was uncomfortable with the amount of leverage.

133. Employees at Stifel’s Alternative Spread Products desk in Baltimore had similar doubts about the structure of the transactions. On July 24, 2006, the leader of Stifel’s Fixed Income department forwarded an email to Stifel’s CEO, directing his attention to an email written by his subordinate. The email reported that a potential CDO provider “had many of the same concerns that we had voiced with respect to the [OPEB] structure. Their feeling is that the structure incorporates too much leverage for them to be comfortable.”

134. Stifel and Noack did not disclose to the School Districts that employees who worked on Stifel’s Alternative Spread Products desk had expressed concerns about the amount of leverage in the GOAL Program.

135. Stifel and Noack ultimately selected RBC Capital Markets as the CDO provider because it offered CDO products with higher yields than its competitors.

136. Meanwhile, Stifel and Noack learned about problems in the performance of the CDO portfolios connected to the Tribune 30 Notes.

137. Stifel and Noack knew about the poor performance of the portfolio in the first transaction. On August 3, 2006, only 37 days after the closing of the first deal, Noack received an email about the portfolio from a representative of RBC Capital Markets. The representative from RBC Capital Markets wrote: “10 names downgraded (model assumes neg watch names downgraded once), 4 by more than one notch. (One name upgraded). Unusual number in a short period of time, has created some risk that note goes on negative watch. . . want to be proactive in warning Stifel of possibility, especially given the concern [Stifel’s CEO] expressed last week about the trade structured for most yield for rating (with not a lot of cushion).”

138. On August 4, 2006, Noack responded that he “want[ed] to know why [the portfolio manager] picked these credits to begin with. Seems like too many credits for increase spread.” Yet Noack’s primary concern was not the first deal, or the public funds invested by West Allis-West Milwaukee. Instead, Noack was concerned with the potential negative consequences that the downgrades could have on Stifel’s ability to grow the GOAL Program and generate profits for Stifel and Noack. “The program,” Noack added, was “1000 times bigger than the first trade.”

139. Noack then asked RBC Capital Markets to buy back the Tribune 30 Notes: “Could we not unwind and buy \$25MM more this time with more conservative portfolio?”

140. Stifel and Noack repeatedly requested that RBC Capital Markets repurchase the notes. RBC Capital Markets declined to do so.

141. On August 4, 2006 – after the credits in the first deal had suffered downgrades – Noack sent an email to Stifel’s CEO. Noack informed the CEO of some of the problems in the Tribune 30 portfolio, and highlighted the need for Stifel to perform “due diligence” on the portfolios. “I originally thought the Baltimore guys would have reviewed the portfolio, but they

did not want the responsibility. Obviously, the Manager has this role. But my belief is that Stifel still needs to look at the credits for our own diligence.”

142. Yet Stifel and Noack did not perform that “due diligence” on the portfolio for the first deal, or on the portfolios for the second or third deals. They did not disclose the lack of due diligence to the School Districts.

143. The representative from RBC Capital Markets sent another email to Noack on August 10, 2006, providing Noack with information that she had learned on a conference call with the portfolio manager. She wrote: “Since closing there were 17 ratings actions, 14 negative and 3 positive. Although downward ratings migration in the underlying portfolio was anticipated, the immediate timing was unexpected.” She further noted that the portfolio’s seven substitutions prevented the notes from being watchlisted, and that the portfolio manager would watch for opportunities to rebuild the reserve account set aside to fund substitutions.

144. Stifel and Noack did nothing to address the portfolio-selection problem. They did not change the structure of the GOAL Program, and they did not investigate the portfolio in the second and third transactions. They did not place additional parameters on how the underlying credits should be selected. Instead, Noack and Stifel promoted the second and third deals totaling \$175 million, leaving the investments exposed to the same vulnerability.

145. The poor performance of the CDOs in the first transaction was material information. Stifel and Noack expressed concerns about the poor performance to RBC Capital Markets, and attempted to convince RBC Capital Markets to repurchase the Tribune 30 Notes.

146. Yet Stifel and Noack concealed the poor performance of the investment from the School Districts. Stifel and Noack did not disclose to the School Districts that a number of the credits in the portfolio had suffered downgrades or were placed on negative credit watch. Stifel

and Noack also did not disclose to the School Districts that they had asked RBC Capital Markets to repurchase the Tribune 30 Notes. Quite the opposite – Stifel and Noack used the completion of the first deal as a marketing tool to encourage other districts to participate in the GOAL Program.

147. Instead, Stifel and Noack represented to West Allis-West Milwaukee that the Tribune 30 Notes were “on course.” And they kept on selling.

### **The Second and Third Investments**

148. Despite the red flags, Stifel and Noack continued to recommend the GOAL Program to the School Districts and promoted additional investments. The School Districts later invested millions of additional dollars into the GOAL Program, without knowing about the poor performance of the first investment.

149. Stifel and Noack did not perform additional due diligence about the portfolios of the synthetic CDOs in the second and third transactions. Before each deal, Stifel admitted in letters to RBC Capital Markets that it had “not undertaken any evaluation or independent investigation of the Securities or the financial assets that secure them.” Stifel did not perform “any evaluation or independent investigation” even though Stifel had “sufficient knowledge and experience in financial and business matters to be able to evaluate the risks and merits of the investment represented by Synthetic CDOs.”

150. Despite the lack of “any evaluation or independent investigation of the Securities or the financial assets that secure them,” Stifel and Noack kept on selling.

151. The second transaction involved investments by OPEB trusts created by three of the five School Districts. WAWM’s OPEB trust participated in the transaction, as did OPEB trusts newly created by Kenosha and by Waukesha, respectively.

152. On September 29, 2006, the three trusts invested \$60 million in Sentinel Limited Series 1 Floating Rate Credit Linked Secured Notes due 2013 (the “Sentinel 1 Notes”). The Sentinel 1 Notes had a rating of AA-.

153. WAWM’s OPEB trust purchased \$17,500,000 of the Sentinel 1 Notes. West Allis-West Milwaukee borrowed \$8,380,000 from a public note issuance and contributed the note proceeds to its trust. WAWM’s OPEB trust borrowed an additional \$9,300,000 from Depfa Bank, with West Allis-West Milwaukee assuming a moral obligation to contribute additional funds to the trust if necessary to keep the Depfa Bank loans fully collateralized.

154. Kenosha’s OPEB trust also purchased \$17,500,000 of the Sentinel 1 Notes. Kenosha borrowed \$9,500,000 through a public note issuance and contributed the note proceeds to its newly-created OPEB trust. Kenosha’s OPEB trust borrowed an additional \$8,200,000 from Depfa Bank, with Kenosha assuming a moral obligation to Depfa Bank, in order to make the investment.

155. Waukesha’s OPEB trust purchased \$25,000,000 of the Sentinel 1 Notes. Waukesha borrowed \$15,670,000 through a public note issuance and contributed the note proceeds to its newly-created OPEB trust. Waukesha’s OPEB trust borrowed an additional \$9,600,000 from Depfa Bank, with Waukesha assuming a moral obligation to Depfa Bank, in order to make the investment.

156. At the time of issuance, the Sentinel 1 Notes offered yields of three-month LIBOR plus 85 basis points, and had a duration of seven years.

157. The attachment point on the Sentinel 1 Notes was 4.50%, and the detachment point on the Sentinel 1 Notes was 5.50%. That is, the trusts would begin losing principal if

losses in the portfolio reached 4.50%, and would lose their entire investment if losses in the portfolio reached 5.50%.

158. Unlike the first deal, the second transaction involved a sale by RBC Capital Markets directly to the OPEB trusts, without an intervening purchase by Stifel.

159. The third transaction involved investments by trusts created by each of the five School Districts, including a trust newly created by Kimberly. On December 21, 2006, the five trusts collectively invested \$115 million in Sentinel Limited Series 2 Floating Rate Credit Linked Secured Notes due 2013 (the “Sentinel 2 Notes”). The Sentinel 2 Notes had a rating of AA-.

160. Kenosha’s OPEB trust made a \$20 million investment in the Sentinel 2 Notes. Kenosha’s OPEB trust borrowed \$20,200,000 from Depfa Bank, with Kenosha assuming a moral obligation to Depfa Bank, in order to make the investment.

161. Kimberly’s OPEB trust made a \$5 million investment in the Sentinel 2 Notes. Kimberly contributed \$800,000 to its newly-created OPEB trust. Kimberly’s OPEB trust borrowed \$4,300,000 from Depfa Bank, with Kimberly assuming a moral obligation to Depfa Bank, in order to make the investment.

162. Waukesha’s OPEB trust made a \$40 million investment in the Sentinel 2 Notes. Waukesha’s OPEB trust borrowed \$40,400,000 from Depfa Bank, with Waukesha assuming a moral obligation to Depfa Bank, in order to make the investment.

163. WAWM’s OPEB trust made a \$40 million investment in the Sentinel 2 Notes. WAWM’s OPEB trust borrowed \$40,400,000 from Depfa Bank, with West Allis-West Milwaukee assuming a moral obligation to Depfa Bank, in order to make the investment.

164. Whitefish Bay’s OPEB trust made a \$10 million investment in the Sentinel 2 Notes. Whitefish Bay contributed \$500,000 to its OPEB trust. Whitefish Bay’s OPEB trust

borrowed \$9,700,000 from Depfa Bank, with Whitefish Bay assuming a moral obligation to Depfa Bank, in order to make the investment.

165. At the time of issuance, the Sentinel 2 Notes offered yields of three-month LIBOR plus 100 basis points, and had a duration of seven years.

166. The attachment point on the Sentinel 2 Notes was 4.60%, and the detachment point on the Tribune 30 Notes was 5.60%. That is, the trusts would begin losing principal if losses in the portfolio reached 4.60%, and would lose its entire investment if losses in the portfolio reached 5.60%.

167. Like the second deal, the third transaction involved a sale of the notes by RBC Capital Markets directly to the OPEB trusts, with Stifel acting as the placement agent.

168. Noack repeatedly told the School Districts that the investments in all three transactions would be in only investment-grade companies. Yet in the third deal, the portfolio manager requested the flexibility to include up to 10% non-investment-grade credits in the portfolio. Noack and Stifel agreed, without disclosing to each of the School Districts that 10% of the portfolio consisted of non-investment-grade credits. To the contrary, Noack reassured one of the School Districts that they were investing only in the highest quality, investment-grade companies.

### **The Unsuitability of the Investments**

169. Stifel and Noack knew, or were reckless in not knowing, that the investments were unsuitable for the needs and investment objectives of the School Districts. They misrepresented the suitability of the investments for the risk-averse School Districts, and they failed to disclose material facts about their unsuitability.

170. Stifel and Noack knew the investment needs of the School Districts. They knew that the School Districts, as public entities, were investing public funds. They knew that the School Districts were conservative, risk-averse investors. They knew that the preservation of capital was one of the most important goals of the School Districts.

171. Stifel and Noack also knew of the relative lack of sophistication of the School Districts. They knew that the School Districts had never before invested in CDOs, or credit default swaps, or any instruments relating to CDOs or credit default swaps. They knew that the School Districts were not the typical buyer for this type of investment, and were less sophisticated than the typical buyers of CDO investments. They knew that nearly all of the board members for each of the School Districts had no background in investing in CDOs or other complex financial instruments. They knew that the School Districts had not retained any other financial advisors in connection with the GOAL Program. They knew that the School Districts lacked the ability to independently assess the credits in the portfolios. They knew that the School Districts were relying on them for financial advice in connection with the investments.

172. Stifel and Noack recommended and sold investments to the School Districts that were inconsistent with their conservative investment objectives. The GOAL Program involved the significant use of leverage, which magnified the risks of a complete loss. To overcome borrowing costs, the GOAL Program favored CDO investments with high yields and thus greater risks. The heightened risks were inconsistent with the School Districts' need for safe, secure investments.

173. The CDO structure itself, combined with the use of leverage, was inconsistent with the conservative investment goals of the School Districts. It offered an investment model

that was ill-suited to their investment needs. In all likelihood, the investments either would achieve their goal, or be completely wiped out.

174. Stifel and Noack did not offer a back-up plan to the School Districts if the investments suffered a complete failure. If the investments failed, the School Districts would be left with tens of millions of dollars of debt – plus a moral obligation on more than \$160 million in debt to Depfa Bank – on top of the unfunded OPEB liabilities.

175. Even if it had performed as promised, the GOAL Program would have provided only a partial solution to the OPEB liabilities facing the School Districts. Collectively, the School Districts had approximately \$600 million of unfunded OPEB liabilities. At best, the GOAL Program offered the possibility of generating slightly more than \$10 million of net income over seven years – less than 2% of the OPEB liabilities.

176. The GOAL Program involved significant risks in the selection of the underlying portfolio. Stifel and Noack failed to disclose those risks, and failed to perform any due diligence on the underlying portfolio before recommending the investments to the School Districts.

177. Stifel and Noack failed to perform a meaningful suitability analysis before promoting and selling the investments to the School Districts. They failed to perform a suitability analysis despite knowing that the School Districts were risk-averse public entities investing public funds.

178. Stifel and Noack also ignored or downplayed warnings from other CDO providers about the risks of the structure of the GOAL Program, including the excessive use of leverage.

179. The offering documents for the Tribune 30 Notes warned Stifel and Noack that the investments were not suitable for the School Districts. In the first transaction, the Tribune 30 note offering memo stated that the investment was “only suitable for investors who . . . are

banks, investment banks, pension funds, insurance companies, securities firms, investment institutions, central governments, large international or supranational organisations or other entities, including *inter alia* treasuries and finance companies of large enterprises which are active on a regular and professional basis in the financial markets for their own account.”

180. Stifel and Noack knew that the School Districts were not “*central governments*.” But they promoted the investments to the School Districts nonetheless.

181. In the second and third deals, RBC Capital Markets sought a representation from Stifel that the investments were, in fact, suitable for the School Districts. Stifel and Noack refused to give that representation.

182. Instead, Stifel and Noack made a generic representation to RBC Capital Markets about CDOs rated AA- in general. Noack executed side letters on behalf of Stifel, stating that “[s]ynthetic collateralized debt obligations carrying a rating of at least ‘AA-’ . . . have been deemed by the Agent (based in part upon representations made by the Districts and the Trusts in letters to the Agent and the issuer of the Securities and upon the legal opinions of the Districts’ counsel) to be a suitable investment for the Trusts . . . .”

183. Stifel and Noack pointedly refused to represent to RBC Capital Markets that the investments were, in fact, suitable for the School Districts. They declined to give that representation because they knew, or were reckless in not knowing, that the investments were unsuitable for the School Districts.

### **The Failure of the Investments**

184. The investments by the School Districts in the GOAL Program were a failure. The investments were far more risky than Stifel and Noack had represented, and those risks materialized – at the expense of the School Districts.

185. In 2007 and 2008, the investments steadily declined in value. The CDO portfolios suffered a series of downgrades. By December 2007, the value of the collateral for the Depfa Bank loans fell below 101%, triggering the moral obligation of the School Districts. The fall in value also triggered an increase in interest rates that eliminated virtually the entire spread between the premiums and the borrowing costs.

186. Certain of the School Districts contributed additional funds to their OPEB trusts to honor the moral obligations, including a \$10 million contribution by West Allis-West Milwaukee in 2008.

187. In 2009 and 2010, the School Districts received word that the second and third investments were a complete loss. In 2010, Depfa Bank redeemed all of the notes and seized all of the assets held in the trusts, including the credit-linked notes on the first transaction.

188. In short, the School Districts have suffered a complete loss of the tens of millions of dollars that they invested in the GOAL Program. They also have suffered credit rating downgrades for failure to honor the “moral obligation” to provide additional funds – the very obligation that, according to Noack, had “no teeth.”

189. Stifel collected significant fees from the GOAL Program. Noack, too, profited from the GOAL Program, earning a sizeable percentage of the overall fees.

190. Stifel and Noack entered into tolling agreements with the Commission, thereby tolling the statute of limitations.

**Claims for Relief**

**Count I**

***Against Defendants Stifel, Nicolaus & Co., Inc. and David W. Noack  
for Violations of Section 10(b) of the Exchange Act  
And Rule 10b-5 Thereunder***

191. The Commission realleges and incorporates by reference paragraphs 1 through 190 as if fully set forth herein.

192. Defendants Noack and Stifel, in connection with the purchase or sale of securities, by the use of the means or instrumentalities of interstate commerce or of the mails, directly or indirectly: (a) used or employed devices, schemes, or artifices to defraud; (b) made untrue statements of material fact or omitted to state material facts necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading; and (c) engaged in acts, practices, or courses of business which operated or would operate as a fraud and deceit upon other persons, including current and prospective investors.

193. Noack and Stifel knowingly or recklessly engaged in the fraudulent conduct described above.

194. By engaging in the conduct described above, Noack and Stifel violated Section 10(b) of the Exchange Act, 15 U.S.C. § 78j(b), and Rule 10b-5 thereunder, 17 C.F.R. § 240.10b-5.

195. In the alternative, Stifel is liable for Noack's violations as a control person under Section 20(a) of the Exchange Act, 15 U.S.C. § 78t(a).

## Count II

### *Against Defendants Stifel, Nicolaus & Co., Inc. and David W. Noack for Violations of Section 17(a)(1) of the Securities Act*

196. The Commission realleges and incorporates by reference paragraphs 1 through 190 as if fully set forth herein.

197. Stifel and Noack, in the offer or sale of securities, by the use of the means and instruments of transportation or communication in interstate commerce or by use of the mails, directly or indirectly, employed devices, schemes or artifices to defraud.

198. Stifel and Noack knowingly or recklessly engaged in the fraudulent conduct described above.

199. By engaging in the conduct described above, Stifel and Noack have violated Section 17(a)(1) of the Securities Act, 15 U.S.C. § 77q(a)(1).

## Count III

### *Against Defendants Stifel, Nicolaus & Co., Inc. and David W. Noack for Violations of Sections 17(a)(2) & 17(a)(3) of the Securities Act*

200. The Commission realleges and incorporates by reference paragraphs 1 through 190 as if fully set forth herein.

201. Stifel and Noack, in the offer or sale of securities, by the use of the means and instruments of transportation or communication in interstate commerce or by use of the mails, directly or indirectly, obtained money or property by means of untrue statements of material fact or omitted to state material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading, and engaged in transactions, practices, or courses of business which operated or would operate as a fraud or deceit upon purchasers of securities.

202. Stifel and Noack knowingly, recklessly or negligently engaged in the fraudulent conduct described above.

203. By engaging in the conduct described above, Stifel and Noack have violated Sections 17(a)(2) and 17(a)(3) of the Securities Act, 15 U.S.C. §§ 77q(a)(2), 77q(a)(3).

#### **Count IV**

***Against Defendant Stifel, Nicolaus & Co., Inc.  
for Violations of Section 15(c)(1)(A) of the Exchange Act***

204. The Commission realleges and incorporates by reference paragraphs 1 through 190 as if fully set forth herein.

205. At all relevant times, Stifel was a registered broker-dealer pursuant to Section 15(b) of the Exchange Act, 15 U.S.C. §78o(b).

206. As alleged herein, Stifel, directly or indirectly, used the mails or the means or instrumentalities of interstate commerce to effect transactions in, or to induce or attempt to induce the purchase or sale of, securities by means of a manipulative, deceptive, or other fraudulent device or contrivance.

207. Stifel knowingly or recklessly engaged in the fraudulent conduct described above.

208. By engaging in the conduct described above, Stifel violated Section 15(c)(1)(A) of the Exchange Act, 15 U.S.C. § 78o(c)(1)(A).

#### **Count V**

***Against Defendant David W. Noack for Aiding and Abetting  
Stifel's Violations of Section 15(c)(1)(A) of the Exchange Act***

209. The Commission realleges and incorporates by reference paragraphs 1 through 190 as if fully set forth herein.

210. At all relevant times, Noack operated as a registered representative and employee of Stifel, a registered broker-dealer, and served in that capacity with respect to his customers.

211. By engaging in the conduct described above, Stifel knowingly or recklessly engaged in fraudulent conduct.

212. Noack knowingly or recklessly provided substantial assistance to Stifel in its violations of Section 15(c)(1)(A) of the Exchange Act, 15 U.S.C. § 78o(c)(1)(A).

213. Under Section 20(e) of the Exchange Act, 15 U.S.C. § 78t(e), Noack aided and abetted Stifel's violations of Section 15(c)(1)(A) of the Exchange Act, 15 U.S.C. § 78o(c)(1)(A).

### **Prayer for Relief**

WHEREFORE, the Commission respectfully requests that the Court:

#### **I.**

Permanently enjoin Defendant Stifel, Nicolaus & Co., Inc. from violating Section 17(a) of the Securities Act, 15 U.S.C. § 77q(a), Section 10(b) of the Exchange Act, 15 U.S.C. § 78j(b), and Rule 10b-5 thereunder, 17 C.F.R. § 240.10b-5, and Section 15(c)(1)(A) of the Exchange Act, 15 U.S.C. § 78o(c)(1)(A).

#### **II.**

Permanently enjoin Defendant David Noack from violating or aiding and abetting violations of Section 17(a) of the Securities Act, 15 U.S.C. § 77q(a), Section 10(b) of the Exchange Act, 15 U.S.C. § 78j(b), and Rule 10b-5 thereunder, 17 C.F.R. § 240.10b-5, and Section 15(c)(1)(A) of the Exchange Act, 15 U.S.C. § 78t(e).

#### **III.**

Order Defendants Stifel, Nicolaus & Co., Inc. and David Noack to disgorge the ill-gotten gains that they received from the violations alleged herein, including prejudgment interest

thereon;

**IV.**

Order Defendants Stifel, Nicolaus & Co., Inc. and David Noack to pay civil penalties pursuant to Section 20 of the Securities Act, 15 U.S.C. § 77t, and Section 21 of the Exchange Act, 15 U.S.C. § 78u-1; and

**V.**

Grant such other relief as the Court deems appropriate.

**Jury Demand**

Pursuant to Rule 38(b) of the Federal Rules of Civil Procedure, Plaintiff demands that this case be tried to a jury on all issues so triable.

Dated: August 10, 2011

Respectfully submitted,

s/ Steven C. Seeger

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