STATE OF MISSISSIPPI
SECRETARY OF STATE
ERIC CLARK

401 MISSISSIPPI STREET
POST OFFICE BOX 136
JACKSON, MISSISSIPPI 39205-0136

TELEPHONE (601) 359-1350
FACSIMILE (601) 359-1499

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Contact: David Blount, 601-359-6342

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Mississippi, Alabama Regulators Assess $225,000 Fine and Penalties Against AmSouth Investment Services

Joint investigation uncovers poor oversight, problems with variable annuities

Secretary of State Eric Clark and the Alabama Securities Commission have assessed $225,000 in fines and penalties against Birmingham-based AmSouth Investment Services, Inc., a subsidiary of AmSouth Bank, for failure to adequately protect investors in two states.

"In this joint investigation involving two state regulators, the SEC and the securities industry, we found a number of cases of poor oversight and, in one case, outright illegal activity by an AmSouth Investment Services representative," Clark said. "Most of the problems we found related to variable annuities and their unsuitability for most investors. This settlement allows all Mississippi victims to get out of their variable annuity without any penalties or sales charges, and implements new policies to protect future investors."

Under the agreement, AmSouth Investment Services will pay a $25,000 fine, reimburse the states $75,000 in investigative costs, and contribute $125,000 for investor education programs in Mississippi and Alabama. Mississippi will receive two-thirds of the total amount; Alabama will receive one-third. AmSouth Investment Services must also pay for an independent review of all internal policies and procedures designed to detect and prevent securities law violations, and improve access to compliance and supervisory rules at every branch office.

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The case began after a routine examination by the Secretary of State's Office investigators discovered illegal activity committed in 2001 by James B. Moorehead of Starkville, an AmSouth Investment Services broker. Clark's office then contacted the Alabama Securities Commission, the Securities and Exchange Commission (SEC), and the National Association of Securities Dealers (NASD). The groups worked together to conduct a sweep of randomly selected branch offices in three states, including AmSouth branches in Florida, the week of December 9-13, 2002.

The Secretary of State's Office estimates that 217 Moorehead clients purchased approximately $15.7 million worth of variable annuities. According to Clark's office, Moorehead failed to obtain required client information, forged and/or directed the forgery of client signatures, knowingly used inaccurate client financial information, sold unsuitable investment products, misrepresented the products sold, and made transactions that were not authorized by his clients. Further examination found that in a 15-month period, Moorehead generated approximately $1 million in commissions from selling variable annuities, an unsuitable investment for many of the investors due to risk and substantial charges for early withdrawal.

Moorehead resigned from AmSouth in April 2001. He faces a Secretary of State's administrative hearing in May where he could be subject to revocation of his securities license and fines of $25,000 per violation of state law. In addition, he faces possible disciplinary action by the National Association of Securities Dealers (NASD), which licenses stock brokers. As part of the agreement with AmSouth Investment Services, the firm will send a letter to all of Moorehead's clients who purchased variable annuities and allow them to get out of the variable annuity investment without incurring any deferred sales charges (i.e., early withdrawal penalty) if they are dissatisfied.

AmSouth Investment Services has already settled with some Moorehead investors and paid back some of the initial investment those investors made with Moorehead, Clark noted.

Clark said the joint investigation allowed regulators to maximize resources on behalf of investors.

"This case shows that state regulators can work with federal regulators and a self-regulating organization [the NASD] to conduct a thorough regional investigation," Clark said. "This is another example of how the states, in addition to federal regulators, play a vital role in protecting small investors."

Variable annuities are complex products that contain both securities and insurance components. While offering tax-deferral, death benefit features, and optional riders, these benefits come with strings attached and additional costs. Variable annuities typically generate high commissions for the selling broker, usually about 6 percent of the purchase amount.

"Most of the problems we uncovered in this investigation boil down to lack of supervision by the firm, the fact that variable annuities are not suitable for all investors, and that the high commissions they generate can lead to unscrupulous behavior," Clark said.

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MORE ON VARIABLE ANNUITIES

USA Today (October 18, 2002): "A study by discount brokerage Charles Schwab suggests only a fairly small group of people need VAs (variable annuities): long-term investors in high tax brackets who have filled all their other investment options." The article adds this warning: "VAs can be one of the more lucrative investment products to sell, and that makes them a tempting sale for brokers who were making top dollar in the bull market."

North American Securities Administrators Association ("Top Ten Scams"): "Sales of variable annuities have increased dramatically over the past decade. As sales have risen, so too have complaints from investors. Regulators are concerned that investors aren't being told about high surrender charges and the steep sales commissions agents often earn when they move investors into variable annuities. Some investors also are misled with claims of guaranteed returns when variable annuity returns actually are vulnerable to the volatility of the stock market. The benefits of variable annuities – tax-deferral, death benefits among others – come with strings attached and additional costs. High commissions often are the driving force for sales of variable annuities. Often pitched to seniors through investment seminars, regulators say these products are unsuitable for many retirees. "Variable annuities make sense only for consumers willing to invest for 10 years or longer, but they are not suitable for many retirees who cannot afford to lock up their money for a long time," said Ralph Lambiase, NASAA's President and Director of the Connecticut Securities Division.

The Securities and Exchange Commission (SEC): "For most investors, it will be advantageous to make the maximum allowable contributions to IRAs and 401(k) plans before investing in a variable annuity. In addition, if you are investing in a variable annuity through a tax-advantaged retirement plan (such as a 401(k) plan or IRA), you will get **no additional tax advantage** from the variable annuity. Under these circumstances, consider buying a variable annuity only if it makes sense because of the annuity's other features, such as lifetime income payments and death benefit protection. The tax rules that apply to variable annuities can be complicated – before investing, you may want to consult a tax adviser about the tax consequences to you of investing in a variable annuity."

CONTACTS FOR INVESTORS

Mississippi Secretary of State's Office (tel. 800-804-6364)
Alabama Securities Commission (tel. 800-222-1253)
Securities and Exchange Commission (tel. 800-SEC-0330)
National Association of Securities Dealers (tel. 800-289-9999)

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