

**FINANCIAL INDUSTRY REGULATORY AUTHORITY  
LETTER OF ACCEPTANCE, WAIVER AND CONSENT  
NO. 2008015443301**

TO: Department of Enforcement  
Financial Industry Regulatory Authority ("FINRA")

RE: UBS Financial Services, Inc. (CRD No. 8174)  
Respondent

Pursuant to FINRA Rule 9216 of FINRA's Code of Procedure, UBS Financial Services, Inc. ("UBS," the "Firm," or the "Respondent") submits this Letter of Acceptance, Waiver and Consent ("AWC") for the purpose of proposing a settlement of the alleged rule violations described below. This AWC is submitted on the condition that, if accepted, FINRA will not bring any future actions against the Firm or its affiliates over which FINRA has jurisdiction alleging violations based on the same factual findings described herein.

**I.**

**ACCEPTANCE AND CONSENT**

- A. UBS hereby accepts and consents, without admitting or denying the findings, and solely for the purposes of this proceeding and any other proceeding brought by or on behalf of FINRA, or to which FINRA is a party, prior to a hearing and without an adjudication of any issue of law or fact, to the entry of the following findings by FINRA:

**BACKGROUND**

UBS, with its predecessor, Paine Webber & Co., has been a registered broker dealer with FINRA since October 1936. The Firm is a full service brokerage firm headquartered in Weehawken, New Jersey and has approximately 385 active branch offices with approximately 6,665 registered Financial Advisors ("FAs").

**RELEVANT DISCIPLINARY HISTORY**

UBS submitted a Letter of Acceptance, Waiver and Consent ("AWC") in which the Firm was censured and fined \$100,000 for supervisory failures that allowed unsuitable short-term sales of closed-end funds (CEF) purchased at the funds' initial public offerings. Despite being aware that CEFs purchased at the initial public offering is most suitable for long-term investments and that short-term trading of these CEFs were generally unsuitable, UBS did not have a supervisory system and procedures reasonably designed to detect and prevent unsuitable patterns of short-term trading of CEFs purchased at the initial public offering. As a result, the Firm failed to detect and prevent certain of its registered representatives from engaging in unsuitable short-term

trading of CEFs purchased at the initial public offering, which resulted in customer losses of more than \$2 million. (FINRA Case # 20070095202) (June 8, 2009).

## **OVERVIEW**

Beginning in the fourth quarter of 2006, UBS, through its Open Architecture Platform (“OAP”), offered its clients Structured Products (“SP”) from approved financial institutions in addition to those issued by UBS. During the period from March 17, 2008 to June 2008 (the “Relevant Period”), in connection with the Lehman Brothers Holdings Inc. (“Lehman”) 100% Principal Protection Notes (“Lehman PPNs”) that UBS marketed and sold, UBS:

(i) made statements and omitted certain facts through communications through some of its FAs, which had the effect of misleading certain customers regarding characteristics and risks associated with investing in Lehman PPNs, including material information regarding the product’s “100% Principal Protection” feature;

(ii) failed to disseminate adequately to its FAs and provide sufficient guidance on the use of certain information, including issuer credit risk and widening of credit default swap spreads, as they related to Lehman’s financial strength during the Relevant Period;

(iii) failed to establish an adequate supervisory system, including adequate training of FAs and written supervisory policies and procedures, in connection with the marketing and sale of Lehman PPNs; and

(iv) did not adequately analyze the suitability of sales of Lehman PPNs to certain UBS customers through some of its FAs.

In addition, before and during the Relevant Period, UBS created and used certain advertising and marketing materials that were not fair and balanced, which had the effect of misleading certain customers regarding specific characteristics of SPs, including Lehman PPNs, related to issuer credit risk.

## **FACTS AND VIOLATIVE CONDUCT**

While broker dealers have sold SPs since the 1980s, SPs were not widely available to retail investors until the early 2000s. SEC Rule 434(h) defines structured securities as “securities whose cash flow characteristics depend upon one or more indices or that have embedded forwards or options or securities where an investor’s investment return and the issuer’s payment obligation are contingent on, or highly sensitive to, changes in the value of underlying assets, indices, interest rates or cash flows.” In some UBS materials, a SP is described as a combination of the characteristics of a traditional or non-traditional investment with financial derivatives.

### **UBS Open Architecture Platform**

In 2006, UBS developed the OAP to provide its customers with the opportunity to purchase SPs issued by other approved financial institutions in addition to those offered by UBS AG (collectively referred to as “third-party issuers”). After the Firm evaluated a potential third-party issuer’s product capabilities and creditworthiness and conducted a vetting process, the Firm

would then approve the new issuer, if appropriate. The Firm conducted on-going due diligence of its third-party issuers.

At the beginning of each month, UBS's SP Development Group ("SP DG"), with input from FAs, third-party issuers, and others, identified certain types and terms of SPs that it would consider issuing the following month. UBS gave approved issuers an opportunity to bid through an auction, i.e. establish the price at which the issuer was willing to offer each product. After evaluating the bids against various benchmarks (including beneficial pricing, diversity of issuer, and available product types), UBS's SP DG would then select an issuer for each product. Thereafter, the SP DG would coordinate with different third-party issuers to determine the final terms for each SP.

The SPs offered through the OAP provided different maturities, reference assets,<sup>1</sup> risk profiles and third-party issuers, which were "A" rated or better by Nationally Recognized Statistical Ratings Organizations or "NRSROs". UBS's monthly offerings were divided into four broad categories based on differing levels of risk and return—Protection, Optimization, Performance and Leverage. The Protection Strategy SPs were designed "for investors who need full or a high degree of principal protection (80-100% protection at maturity) and seek potential returns in excess of traditional bonds." The Protection Strategy SPs included Principal Protection Notes ("PPNs") and Equity Linked Certificates of Deposit.

Throughout the year, the Firm trained UBS SP Regional Consultants ("SP RC") and the SP Sales Desk ("Sales Desk") on the monthly offerings and placed educational and marketing materials, prospectuses, term sheets and other materials on the Firm's Intranet. The SP RC made branch and other on-site visits to educate FAs regarding the Firm's monthly offerings of SPs and market the SPs to them. After the SP RC visited a branch office, or in the event the SP RC did not visit a branch or on-site office, the Sales Desk staff was available to address questions from FAs. The Sales Desk also distributed educational and marketing materials to FAs on a SP distribution list.

Since 2005, UBS has also offered online training to its FAs regarding SPs. An online training module for SPs has been available since September 15, 2005, became mandatory in October 2008, and has been completed by many registered employees. In addition to the online training module, UBS conducted live classroom training sessions regarding SPs. FAs could sell a SP without taking the online training module or attending a live classroom training session.

In any given monthly offering period, FAs solicited SP purchases and indications of interest from their customers. All orders were executed on the offer closing date, usually at the end of the month. On the closing date, the final terms of the product were established and UBS, as required, made available final prospectuses or "pricing supplements" to customers. The final prospectuses reflected the final terms of the product. The notional value of the transaction consisted of only the orders obtained by UBS FAs. During the time period that the Firm offered Lehman SPs, UBS did not maintain an inventory of SPs or purchase the SPs for its proprietary accounts. UBS expected, but did not require, the issuers to maintain a secondary market in the SPs they issued.

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<sup>1</sup> The reference asset is the asset underlying the derivative component of a SP, upon which the return depends.

## Structured Products Sales Procedures

In February 2007, UBS added Lehman as an approved third-party issuer on the OAP, with the first Lehman issued SPs offered in March 2007. By January 2008, UBS offered SPs of five issuers, including UBS AG. During any given month, UBS offered 20 to 30 SPs.

In the beginning of 2008, the credit crisis resulted in a substantial contraction in the U.S. financial markets, which impacted several financial institutions. On March 14, 2008, the Federal Reserve helped Bear Stearns avoid filing for bankruptcy by facilitating the sale of Bear Stearns to JPMorgan Chase (“JPMorgan”). During the period following Bear Stearns’ acquisition by JPMorgan, there was market speculation regarding Lehman having to be acquired in order to remain viable and avoid financial failure. Lehman’s and other financial institutions’ credit default swap (“CDS”)<sup>2</sup> spreads widened substantially. The widening of Lehman’s CDS spreads was an indicator of the market’s perception of Lehman’s declining financial strength.

In light of market events, on or about March 14, 2008, UBS instructed the SP DG to review its third-party issuers carefully, especially Lehman, before committing to any offerings for the following month. After internal discussions within UBS, the Firm decided to continue offering Lehman’s and other third-party issuers’ SPs. Going forward monthly rather than quarterly, UBS initiated heightened credit checks on all issuers. Further, the SP DG also instituted guidelines on its Lehman issued SP offerings, including an 18-month maturity limit. On March 18, 2008, SP DG also conducted a conference call for FAs regarding third-party issuers to answer FAs’ questions and concerns. The conference call covered issuer credit quality, liquidity and secondary market issues.

During the Relevant Period, UBS did not have risk profile requirements for customers who purchased PPNs linked to broad-based indices, such as the S&P 500. Accordingly, all customers, including those with a conservative risk objective, were eligible to purchase PPNs linked to broad-based indices.

On June 2, 2008, Standard and Poor’s placed a negative outlook on the large financial institution sector and downgraded Lehman debt from an “A+” to an “A.” Further, Lehman’s CDS spreads widened during certain time periods in the month of June. On June 9, 2008, Lehman pre-announced a second quarter loss of \$2.8 billion and announced that it would seek an additional \$6 billion in new capital. On June 12, 2008, Lehman removed its Chief Financial Officer and its Chief Operating Officer and President from their respective positions. As a result of the change in Lehman’s management and the volatility of the credit markets, UBS instituted a hiatus on ticketing of June orders for Lehman-issued SPs. On June 18, 2008, UBS lifted the hiatus on ticketing orders after Lehman issued second-quarter financial results, which were consistent with the pre-announcement, and Lehman’s CDS spreads contracted. The Firm did not offer Lehman-issued SPs in July because trading in Lehman-issued SPs had been suspended during the OAP auction process. In August and September 2008, UBS did not offer Lehman-issued SPs via the OAP.

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<sup>2</sup> Credit default swaps are a type of credit insurance contract in which one party pays another party to protect it from the risk of default on a particular debt instrument. If that debt instrument defaults, the insurer compensates the insured for the loss.

When Lehman's efforts to raise additional capital and/or find a merger or acquisition partner proved unsuccessful, Lehman filed for bankruptcy protection on September 15, 2008. In response to the bankruptcy announcement, UBS conducted a conference call and advised its sales force to notify customers that because UBS could not provide accurate pricing for Lehman SPs in the wake of Lehman's bankruptcy, client statements would indicate that "[t]he lending value of all instruments related to Lehman has been set to 0%," and that Lehman SPs "will contribute zero to account valuation." The Firm instructed FAs that this was not an indication of the actual value of the Lehman SPs.

**A. Statements and Omissions Having the Effect of Misleading Certain Customers**

**1. Inadequate Disclosures and FAs' Failure to Accurately Describe Lehman PPNs to Certain Customers During the Relevant Period**

NASD Rule 2110 requires that firms and registered and associated persons "observe high standards of commercial honor and just and equitable principles of trade." UBS violated NASD Rule 2110 by making statements and omitting certain facts through FAs, including material information regarding Lehman PPNs that may have misled certain customers. Despite UBS's efforts during the Relevant Period to (a) educate FAs about SPs (training classes, conferences, prospectus delivery, and online modules), and (b) ensure that FAs emphasized credit risk in discussions with customers, certain SP educational and marketing materials may have been confusing with respect to the characteristics and risks of Lehman PPNs, including the nature, scope and limitations of the product's "100% Principal Protection." The aforementioned inadequacies in the Firm's educational and marketing material may have resulted in some FAs having misunderstood the product. Further, based on these FAs' misunderstandings of the product, certain FAs in turn may have communicated inadequate and/or incorrect information to some Firm customers.

In addition, certain marketing and educational materials made available to FAs suggested that customers would, at a minimum, receive a return of principal at maturity of the notes. With respect to the Lehman PPNs, the risk disclosure that qualified the protection of principal, i.e., "subject to the credit risk of the issuer," was very often on the last page of a multi-page document or not prominently emphasized within the section that discussed the risks of SPs. Further, many documents available to FAs with different descriptions of Lehman PPNs led to certain misunderstandings among some FAs within UBS's sales force, including:

1. Certain FAs did not understand the source of the principal protection:
  - Certain FAs were not aware that the notes were unsecured debts of the issuer and the principal protection was contingent on the ability of the issuer to meet its obligations at maturity,
  - Certain FAs believed that the zero coupon bond supporting the Lehman PPN was a U.S. Treasury note,
  - Certain FAs did not know that UBS did not guarantee the issuer's debt.

2. Certain FAs did not understand the relationship between UBS and the third-party issuer:
  - Certain FAs did not understand that UBS was not the issuer of all of the SPs, and some FAs failed to identify the issuer,
  - Certain FAs believed that the Lehman PPN had a separate bond component being held in escrow or other segregated account,
  - Certain FAs believed that Lehman was required to purchase hedges to support the Lehman PPNs.
3. Certain FAs did not understand the relationship between the pricing of the products and the creditworthiness of the issuer.<sup>3</sup>
  - Many FAs were not aware that issuers with a lower credit rating were able to offer the PPNs with better terms because of their increased cost of funds.<sup>4</sup>

## **2. UBS Failed to Disseminate Adequately to its FAs Certain Market Information Relating to Lehman's Financial Condition**

During the Relevant Period, there were certain market events regarding Lehman that were potentially relevant to its overall creditworthiness. These events included, 1) widening CDS spreads for Lehman and other financial institutions after JPMorgan acquired Bear Stearns, 2) credit rating agency's downgrade, 3) Lehman's \$2.8 billion second quarter loss, and 4) the resignation of two Lehman executives. Further, UBS suspended order ticketing of Lehman-issued SPs for six days in June 2008. While UBS recognized the need to enhance its credit check procedures for its SP third-party issuers, including Lehman, UBS, through its FAs, did not provide some customers with material information that would have provided a fair and balanced presentation of the benefits and risks of purchasing Lehman PPNs. Additionally, during the Relevant Period, in certain internal and customer-targeted marketing materials, UBS did not adequately emphasize Lehman's credit risk in light of market events. Moreover, the Firm did not adequately advise certain of its FAs that Lehman's lower credit rating could result in more favorable terms on its PPNs. This caused some customers to purchase Lehman PPNs without understanding that the more favorable terms compared to other issuers were directly related to Lehman's lower credit rating. Accordingly, during this critical period, the Firm did not provide to certain FAs and customers a fair or balanced portrayal of Lehman as a third-party SP issuer. While Lehman's bankruptcy was generally unexpected by the market, in order to make a more informed decision whether to offer or to purchase the Lehman PPNs during this period, certain FAs and customers would have benefited from more complete and balanced disclosures regarding the above described market events.

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<sup>3</sup>Since some FAs failed to appreciate the importance of issuer credit risk, certain FAs marketed the SPs based on the maturity or reference asset. The Monthly Strategies Guide on average contained 30 SPs, seven of which were PPNs, and only one of which may have had a 12-month maturity and was linked to the S&P 500. Accordingly, in any given month, an FA in the market for a PPN with a 12-month maturity linked to the S&P may have had only one option for that particular product. Accordingly, certain FAs may have sold a SP based on its maturity or reference asset without mentioning the corresponding issuer.

<sup>4</sup>Lehman was able to provide more competitive pricing in the auction process due to its increasing funding costs as its credit rating declined. Due to the lack of transparency, however, many FAs did not understand that the attractive pricing was due to Lehman's credit rating.

## **B. Supervision Violations**

NASD Rule 3010 requires each member firm to establish and maintain a system, including written procedures, to supervise the activities of its employees that are reasonably designed to achieve compliance with the federal securities laws and NASD rules. In violation of NASD Rules 3010 and 2110, UBS failed to establish and maintain a supervisory system that was reasonably designed to achieve compliance with NASD rules in the marketing and sale of Lehman PPNs during the Relevant Period.

### **1. Supervision of FA Training**

FA training in SPs consisted of online training modules, seminars, formal classroom training, in-branch training conducted by SP RC, and/or materials made available on the Firm's Intranet and disseminated to the SP distribution list. While UBS made the aforementioned resources available to its FAs during the Relevant Period, the FAs were not required to avail themselves of any training prior to selling SPs, including Lehman PPNs.

In addition, UBS's FA training on PPNs did not adequately meet all aspects of the guidance established by Notice to Members ("NTM") 05-59, with respect to selling Lehman PPNs. These requirements include the following: (1) provide balanced disclosure in promotional efforts; (2) ascertain accounts eligible to purchase structured products; (3) deal fairly with customers with regard to derivative products; (4) perform a reasonable-basis suitability determination; (5) perform a customer-specific suitability determination; (6) supervise and maintain a supervisory control system; and (7) train associated persons.

As a result, UBS failed to provide adequate training for its FAs regarding the features and characteristics of Lehman PPNs, especially the characteristics regarding an issuer's creditworthiness during the Relevant Period. Further, UBS failed to maintain policies and procedures that were reasonably designed to ensure that all registered representatives adequately: a) described Lehman PPNs to customers, b) identified the issuer of Lehman PPNs, and c) provided customers with full disclosure of the risks associated with Lehman PPN investments.

### **2. Supervision of Sales Practices**

UBS's policies and procedures permitted FAs to sell certain Lehman PPNs to customers regardless of risk profile because certain PPNs had no risk profile requirements.<sup>5</sup> In light of the risks associated with investing in Lehman PPNs during the Relevant Period, UBS sold Lehman PPNs to certain customers with a "conservative" or "moderate" risk profile, and did not provide sufficient protections to prevent sales to certain of these customers for whom they were not suitable.

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<sup>5</sup>As an eligibility requirement for the typical 100% PPN, a customer needed to have a net worth of \$150,000, an annual income of \$50,000, and "aggressive/speculative" or "moderate" as one of the top two risk profiles. Risk profile requirements did not apply to PPNs linked to a "broad-based index such as the S&P 500."

Further, as additional information became available in the market regarding Lehman's credit risk and CDS spreads, the Firm did not have a procedure to adequately disseminate this information to FAs or to ensure that FAs communicated the information to their customers.

### **C. During the Relevant Period Certain Sales of Lehman PPNs Were Unsuitable**

NASD Rule 2310 requires that, prior to recommending the purchase of any security, "a member shall have reasonable grounds for believing that the recommendation is suitable for such customer upon the basis of the facts, if any, disclosed by such customer . . . and as to his financial situation and needs." IM-2310-2 requires firms and registered representatives "to deal fairly" with the public in connection with sales efforts. Under IM-2310-2, the standard is whether sales efforts "can be reasonably said to represent fair treatment for the persons to whom the sales efforts are directed ...."

During the Relevant Period, Firm customers who had a "conservative" account risk profile and certain Firm customers who had a "moderate" account risk profile were more likely to rely on the Firm's representations about the "100% Principal Protection" feature of Lehman PPNs. Accordingly, Lehman PPNs were unsuitable during the Relevant Period for some of these specific investors because the product was inconsistent with the customers' investment objectives. Further, the risks associated with the product increased as Lehman's credit risk became a significant factor. As a result, the Lehman PPN sales were unsuitable for certain customers because the Firm lacked a reasonable basis to believe that the product met the customers' financial situation and needs.

Further, in light of the misunderstandings that certain FAs had regarding Lehman PPNs, these FAs could not properly evaluate the suitability of the product for their customers. As a result, UBS, through certain of its FAs, effected unsuitable sales of Lehman PPNs to certain customers. Based upon these facts, UBS violated NASD Rules 2310 and 2110 and IM-2310-2.

### **D. Advertising Rule Violations**

SPs are hybrid financial products comprised of a note and a derivative. As SP sales to retail customers increased over time, FINRA issued NTM 05-59 to remind broker-dealers that IM-2310-2(e) requires that "[a]s new products are introduced from time to time, it is important that members make every effort to familiarize themselves with each customer's financial situation, trading experience, and ability to meet the risks involved with such products and to make every effort to make customers aware of the pertinent information regarding the products." In late 2006, UBS, via its newly developed OAP, offered customers non-proprietary SPs of third-party issuers. As a result of NTM 05-59, UBS had a heightened duty to educate its FAs regarding the relevant and material risks related to SP sales based upon these new products, including the relationship between UBS and credit risks related to SP products offered by third-party issuers.

In addition, the UBS marketing and educational materials were required to provide a fair and balanced presentation of the characteristics of SPs pursuant to NASD Rules 2210 and 2211. NASD Rule 2210(d)(1)(A) requires that:

All member communications with the public shall be based on principles of fair dealing and good faith, must be fair and balanced, and must provide a sound basis for evaluating the facts in regard to any particular security or type of security, industry or service.

NASD Rule 2211 provides that materials distributed to registered or associated persons must also meet the requirements of NASD Rule 2210(d)(1).

## **1. Customer Directed Marketing Materials**

Before and throughout the Relevant Period, UBS, through its FAs, made available to Firm customers a *Client Strategies Guide* (“the Client Guide”). The Client Guide listed the SPs available for sale that month. The information regarding PPNs contained in the Client Guide was not fair and balanced in that it repeatedly mentioned the following: “100% Principal Protection” in the title of the products; “Principal Protection available only if the product is held to maturity”; and “100% principal protection at maturity.” The aforementioned references to principal protection suggested to the investor that holding to maturity was the only condition on the protection feature. Further, the disclosure that “[s]tructured products are obligations of the applicable issuer” was contained on the last page in the section entitled “General Risks of Structured Products Investing.” The credit risk disclosure was not prominently placed relative to the references to principal protection, and did not adequately emphasize the relationship between the protection of principal and the issuer’s credit risk. Specifically, the last page of the Client Guide contained the following disclosure: “The creditworthiness of the issuer does not affect or enhance the likely performance of the investment other than the ability of the issuer to meet its obligations.” This “disclosure” does not sufficiently emphasize that an investor who purchased a “100% Principal Protection Note” could lose all principal in the event of default. In the post-Bear Stearns time period, emphasis on credit risk became more important given market events.

Additionally, certain Firm customers were provided with copies of the *Structured Products: Strategies for Portfolio Diversification and Risk Management* guide, which did not have a fair and balanced PPN risk disclosure. While in the section titled “Investment Considerations,” the Firm specifically disclosed that “[w]hen you purchase a structured product, you own a security that is backed by the issuing firm,” the Firm failed to repeat disclosures regarding issuer credit risk in the section of the document that listed the characteristics and risks specifically associated with purchasing PPNs.

### Failure to Provide Fair and Balanced Disclosures Regarding Lehman’s Credit Risk

As the public speculation regarding Lehman’s financial condition increased during the Relevant Period and its CDS spreads widened, the Firm failed to update its marketing and educational materials to emphasize the importance of Lehman’s credit risk to certain Firm customers. Such information was important to determining the suitability of the Lehman PPN. For example, all UBS marketing materials used during the Relevant Period should have provided a more balanced discussion of credit risk, including currently available information once concerns heightened regarding Lehman’s financial strength. The failure to disclose this material information was a violation of NASD Rules 2210(d)(1)(B) and 2110.

Specifically, *Open Architecture for Structured Products* describes UBS' due diligence process: "Each of our partners is subjected to a rigorous and on-going legal, operational and business due diligence process." However, with respect to Lehman's declining creditworthiness, *Open Architecture for Structured Products* failed to disclose information about Lehman's credit risk and financial condition. Specifically, UBS did not emphasize the importance of credit risk as to Lehman in March 2008, in light of other market concerns and that Lehman's credit default swap spreads were widening. Therefore, Lehman's creditworthiness in *Open Architecture for Structured Products* as of May 18, 2008, was not fair and balanced, and thus misleading because it failed to emphasize adequately other market information about Lehman's credit risk.

## **2. Internal Use Only Educational and Training Materials**

From March to September 2008, UBS made available to its FAs numerous educational and training materials regarding SPs. Some of these materials 1) lacked sufficient information necessary to provide a fair and balanced evaluation of the risks associated with PPNs, including the risks associated with the issuer's creditworthiness, 2) contained exaggerated, unwarranted, or unbalanced, and hence, misleading, statements regarding the characteristics of the PPNs, 3) failed to provide a fair and balanced platform for evaluating the characteristics of a PPN, or 4) omitted certain material facts which made the communications unbalanced, and hence, misleading. Three representative documents relating to the sale of Lehman PPNs violated FINRA's advertising rules.

In connection with the sale of Lehman PPNs, certain FAs received and relied upon the UBS *Monthly Strategies Guide*. Each month, UBS issued and distributed or made available to FAs, a Monthly Strategies Guide that described the characteristics and terms of the Firm's monthly SP offerings. Like the Monthly Strategies guides for customers that contained a brief reference to issuer credit risk, the Monthly Strategies Guide that UBS distributed to FAs made multiple references to the PPN's characteristics of "100% Principal Protection" and "100% principal protection at maturity." The credit risk disclosure in the Monthly Strategies Guide was not prominently placed relative to the references to 100% principal protection and does not adequately explain the relationship between the protection of principal and the issuer's credit risk.

Moreover, the FA Monthly Strategies Guide did not disclose that the PPNs were "the obligations of the applicable issuer" or provide notice that if an issuer defaulted, a customer could lose their entire investment. The failure to contain an appropriate credit risk disclosure violated NASD Rules 2210(d)(1)(A), 2211 and 2110 in that 1) it did not present a fair and balanced treatment of the risk and rewards of the SPs, and 2) did not provide a fair and balanced platform for evaluating the characteristics and suitability of the SPs.

Further, statements regarding "100% principal protection at maturity" contained in the FA Monthly Strategies Guide are exaggerated and unbalanced in violation of NASD Rules 2210(d)(1)(B), 2211 and 2110 in that they could imply that there is no risk to principal as long as the products are held to maturity.

As part of their classroom training in SPs, certain FAs received an internal UBS document titled *Moving Ahead with Structured Products* (“Moving Ahead”). In addition to providing general training and information regarding SPs, including PPNs, Moving Ahead contained an illustration that a \$100 Note was composed of 1) a \$75 zero-coupon bond “based on issuer’s cost of funding,” 2) a \$21.50 at-the-money call option “based on investment bank’s price,” and 3) \$3.50 in fees, which is unwarranted in that it does not clearly state that the note is a single hybrid instrument.

UBS also made available to FAs a document titled *Efficient Portfolio Construction with PPN Linked to a Global Index Basket: SP Development White Paper* (“White Paper”). The White Paper contained the following statement: “[a]t maturity, there are two payout scenarios: principal plus a positive index return or just principal.” That statement implies that there are only two possible outcomes and does not present the possibility that the customers may lose their investment. Further, the document refers to the characteristics and performance of a hypothetical PPN. Regarding the characteristics of a PPN, the document’s references to a hypothetical PPN and a general PPN could lead to confusion. The White Paper also contained unwarranted references to targeted returns (“11.96% Target Return”) and historical performance comparisons (“We compared two portfolios over the same time period...[t]he results show that the portfolio with the PPN would have provided higher returns than the portfolio with the Lehman Aggregate.”)

Finally, although the document noted that “investors should consider the credit risk of the issuer prior to investing,” this credit risk disclosure was not prominently placed relative to the references to principal protection.

### **OTHER FACTORS**

UBS has already paid, either through settlements or arbitration awards, approximately \$14.5 Million to certain investors who purchased the Lehman PPNs from March 2008 to June 2008.

B. UBS also consents to the imposition of the following sanctions:

- a. Censure,
- b. \$2.5 Million Fine,
- c. Customer Restitution of \$8.25 Million<sup>6</sup>

The restitution is to be paid to certain UBS customers who purchased Lehman PPNs from UBS during the period from March 17, 2008 to June 30, 2008 and hold those Lehman PPNs as of the approval date of this AWC (“Eligible Purchases”). Restitution under this AWC is limited to (i) joint and individual

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<sup>6</sup> Restitution will not be paid to customers who entered into a settlement agreement with UBS, or otherwise previously agreed to resolution of their claims with UBS, relating to the facts of this AWC, on or before the date of this AWC. Classes of customers who are entitled to restitution pursuant to this AWC, and who enter into a settlement agreement with UBS from the date of March 1, 2011 until this AWC is approved, will receive no less than the restitution they would be entitled to pursuant to this AWC.

account customers who are natural persons and (ii) joint and individual trust account customers where the beneficiary of the trust is a natural person or persons. Only the following classes of customers who meet the criteria in this paragraph and who had, as reflected on the Firm's official books and records for the accounts in which the Eligible Purchases were executed, the following net worth and risk profiles at the time of their investment will receive restitution:<sup>7</sup>

1. Investors with a primary risk profile of "Conservative" will receive 100% of invested principal minus the market value of the notes that they still possess as determined on the date of the Notice of Acceptance of this AWC by UBS and FINRA; and
2. Investors with a primary risk profile of "Moderate" and \$1 million or less in net worth will receive 50% of invested principal.

Based on the foregoing, FINRA and UBS have agreed and determined that the above classes of customers are entitled to restitution pursuant to this AWC. The above classes of customers will also retain the notes, the value of which is currently determined by prevailing market conditions.

The sanctions imposed herein shall be effective on a date set by FINRA staff.

UBS agrees to pay the monetary sanction(s) upon notice that this AWC has been accepted and that such payment(s) are due and payable. UBS has submitted an Election of Payment form showing the method by which it proposes to pay the fine imposed.

Within 60 days from the date of the Notice of Acceptance of this AWC, UBS will provide to FINRA a schedule of customers that fall within the classes outlined above in the AWC. Upon approval by FINRA, restitution will be ordered to be paid within 120 days to the customer(s) listed on the schedule in the total amount of \$8.25 million. Restitution is ordered to be paid to the customer(s) listed on the schedule hereto in the total amount of \$8.25 million, plus interest at the rate set forth in Section 6621(a)(2) of the Internal Revenue Code, 26 U.S.C. 6621(a)(2), from the date that each Lehman PPN matures until the date this AWC is accepted by the NAC. A registered principal on behalf of UBS shall submit satisfactory proof of payment of restitution or of reasonable and documented efforts undertaken to effect restitution. Such proof shall be submitted to Enforcement Senior Counsel Miranda Chatelain, at the Department of

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<sup>7</sup> During the Relevant Period, out of all the customers that purchased the Lehman PPNs from UBS, approximately \$16.23 million of the Lehman PPNs were sold to 764 unique customer accounts relating to investors who either had a "conservative" risk profile or had a "moderate" risk profile with a net worth of \$1 million or less. With respect to the aforementioned sales, during the Relevant Periods, UBS earned approximately \$228,630 in fees and commissions.

Enforcement, 14 Wall Street, 14<sup>th</sup> Floor, New York, NY either by letter that identifies UBS (Matter No. 2008015443301) or by e-mail from a work-related account of the registered principal of UBS to EnforcementNotice@FINRA.org. This proof shall be provided to the FINRA staff member listed above no later than 120 days after the date of payment.

If for any reason UBS cannot locate any customer identified in the schedule after reasonable and documented efforts within 120 days from the date of payment, or such additional period agreed to by a FINRA staff member in writing, UBS shall forward any undistributed restitution and interest to the appropriate escheat, unclaimed property or abandoned property fund for the state in which the customer is last known to have resided. UBS shall provide satisfactory proof of such action to the FINRA staff member identified above and in the manner described above, within 45 days of forwarding the undistributed restitution and interest to the appropriate state authority.

UBS has specifically and voluntarily waived any right to claim an inability to pay at any time hereafter the monetary sanction(s) imposed in this matter.

The imposition of a restitution order or any other monetary sanction herein, and the timing of such ordered payments, does not preclude customers from pursuing their own actions to obtain restitution or other remedies.

## **II.**

### **WAIVER OF PROCEDURAL RIGHTS**

UBS specifically and voluntarily waives the following rights granted under FINRA's Code of Procedure:

- A. To have a Complaint issued specifying the allegations against it;
- B. To be notified of the Complaint and have the opportunity to answer the allegations in writing;
- C. To defend against the allegations in a disciplinary hearing before a hearing panel, to have a written record of the hearing made and to have a written decision issued; and
- D. To appeal any such decision to the National Adjudicatory Council ("NAC") and then to the U.S. Securities and Exchange Commission and a U.S. Court of Appeals.

Further, UBS specifically and voluntarily waives any right to claim bias or prejudgment of the

General Counsel, the NAC, or any member of the NAC, in connection with such person's or body's participation in discussions regarding the terms and conditions of this AWC, or other consideration of this AWC, including acceptance or rejection of this AWC.

UBS further specifically and voluntarily waives any right to claim that a person violated the ex parte prohibitions of FINRA Rule 9143 or the separation of functions prohibitions of FINRA Rule 9144, in connection with such person's or body's participation in discussions regarding the terms and conditions of this AWC, or other consideration of this AWC, including its acceptance or rejection.

### **III.**

#### **OTHER MATTERS**

UBS understands that:

- A. Submission of this AWC is voluntary and will not resolve this matter unless and until it has been reviewed and accepted by the NAC, a Review Subcommittee of the NAC, or the Office of Disciplinary Affairs ("ODA"), pursuant to FINRA Rule 9216;
- B. If this AWC is not accepted, its submission will not be used as evidence to prove any of the allegations against UBS; and
- C. If accepted:
  - 1. this AWC will become part of UBS's permanent disciplinary record and may be considered in any future actions brought by FINRA or any other regulator against it;
  - 2. this AWC will be made available through FINRA's public disclosure program in response to public inquiries about UBS's disciplinary record;
  - 3. FINRA may make a public announcement concerning this agreement and the subject matter thereof in accordance with FINRA Rule 8313; and
  - 4. UBS may not take any action or make or permit to be made any public statement, including in regulatory filings or otherwise, denying, directly or indirectly, any finding in this AWC or create the impression that the AWC is without factual basis. UBS may not take any position in any proceeding brought by or on behalf of FINRA, or to which FINRA is a party, that is inconsistent with any part of this AWC. Nothing in this provision affects UBS's right to take legal or factual positions in litigation or other legal proceedings in which FINRA is not a party.

- D. UBS may attach a Corrective Action Statement to this AWC that is a statement of demonstrable corrective steps taken to prevent future misconduct. UBS understands that it may not deny the charges or make any statement that is inconsistent with the AWC in this Statement. This Statement does not constitute factual or legal findings by FINRA, nor does it reflect the views of FINRA or its staff.


The undersigned, on behalf of the Firm, certify that a person duly authorized to act on its behalf has read and understands all of the provisions of this AWC and has been given a full opportunity to ask questions about it; that UBS has agreed to its provisions voluntarily; and that no offer, threat, inducement, or promise of any kind, other than the terms set forth herein and the prospect of avoiding the issuance of a Complaint, has been made to induce UBS to submit it.

Date 4/1/11

  
UBS Financial Services Inc.

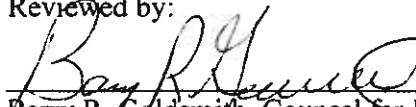
By: Jonathan Eisenberg, Esq.  
Managing Director, General Counsel

Date 4/1/11

  
UBS Financial Services Inc.

By: Ilene Marquardt, Esq.  
Managing Director,  
Senior Deputy General Counsel

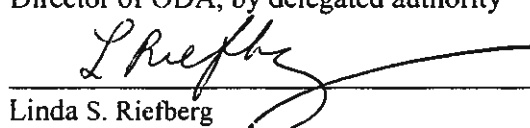
Reviewed by:

  
Barry R. Goldsmith, Counsel for Respondent  
Gibson, Dunn & Crutcher LLP  
200 Park Avenue  
New York, NY 10166

Accepted by FINRA:

4/8/11  
Date

Signed on behalf of the  
Director of ODA, by delegated authority

  
Linda S. Riefberg  
Vice President  
FINRA Department of Enforcement  
14 Wall Street  
New York, N.Y. 10005  
Telephone: 646-315-7395  
Facsimile: 646-315-7441