

**FINANCIAL INDUSTRY REGULATORY AUTHORITY  
LETTER OF ACCEPTANCE, WAIVER AND CONSENT  
NO. 20090182292**

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

RE: UBS Financial Services Inc. ("UBS FS," "Respondent" or "the Firm"),  
CRD No. 8174

Pursuant to FINRA Rule 9216 of FINRA's Code of Procedure, UBS FS 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 UBS FS alleging violations based on the same factual findings described herein.

**I.**

**ACCEPTANCE AND CONSENT**

- A. UBS FS 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 FS, with its predecessor, PaineWebber & Co., has been a FINRA-registered broker-dealer since October 1936. UBS FS is a full service brokerage firm headquartered in Weehawken, New Jersey. UBS FS has approximately 385 active branch offices with about 7,000 registered financial advisors.

**RELEVANT DISCIPLINARY HISTORY**

UBS FS has the following relevant disciplinary history:

In April 2011, UBS FS consented to a \$2.5 million fine and restitution of \$8.25 million for, among other things, violating NASD Rules 3010 and 2310 between March 17, 2008 and June 30, 2008, in that UBS FS: (1) failed to establish an adequate supervisory system, including adequate training and written supervisory policies and procedures, in connection with the marketing and sale of Lehman Brothers Principal Protection Notes ("PPNs"); and (2) failed to adequately

analyze the suitability of sales of Lehman PPNs to certain UBS FS customers through some of its registered representatives. (Letter of Acceptance, Waiver and Consent No. 2008015443301).

In June 2009, UBS FS consented to a \$100,000 fine for supervisory violations relating to unsuitable short-term sales of closed-end funds purchased at the funds' initial public offering, which resulted in customer losses of more than \$2 million. (Letter of Acceptance, Waiver and Consent No. 20070095202).

## **OVERVIEW**

During the period from January 2008 through June 2009 (the "Relevant Period"), UBS FS failed to establish and maintain a supervisory system, including written procedures, reasonably designed to achieve compliance with applicable NASD and/or FINRA rules in connection with the sale of leveraged, inverse, and inverse-leveraged Exchange-Traded Funds ("Non-Traditional ETFs"). Non-Traditional ETFs have certain risks that are not found in traditional ETFs, such as the risks associated with a daily reset, leverage and compounding. The performance of Non-Traditional ETFs over longer periods of time can differ significantly from the performance of their underlying index or benchmark, especially in volatile markets. Nonetheless, UBS FS supervised Non-Traditional ETFs the same way it supervised traditional ETFs. Thus, UBS FS failed to establish a reasonable supervisory system and written procedures to monitor the sale of Non-Traditional ETFs. UBS FS also failed to establish adequate formal training regarding Non-Traditional ETFs during the Relevant Period.

In addition, certain UBS FS registered representatives did not have an adequate understanding of Non-Traditional ETFs before recommending these products to retail brokerage customers. Certain UBS FS registered representatives also made unsuitable recommendations of Non-Traditional ETFs to certain customers with a primary conservative risk tolerance profile.

As such, UBS FS violated NASD Rules 3010, 2310, and 2110 and FINRA Rule 2010.

## **FACTS AND VIOLATIVE CONDUCT**

### **Non-Traditional ETFs**

As described in a FINRA Regulatory Notice issued in June 2009, ETFs are typically registered unit investment trusts (UITs) or open-end investment companies whose shares represent an interest in a portfolio of securities that track an underlying benchmark or index.<sup>1</sup> Shares of ETFs typically are listed on national securities exchanges and trade throughout the day at prices established by the market.

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<sup>1</sup> See FINRA Regulatory Notice ("Notice") 09-31, *Non-Traditional ETFs* (June 2009).

Leveraged ETFs seek to deliver multiples of the performance of the index or benchmark they track. Some Non-Traditional ETFs are “inverse” or “short” funds, meaning that they seek to deliver the opposite of the performance of the index or benchmark they track. Some funds are both inverse and leveraged, meaning that they seek to achieve a return that is a multiple of the inverse performance of the underlying index or benchmark. To accomplish their objectives, Non-Traditional ETFs use swaps, futures contracts and other derivative instruments. UBS FS was not involved in the creation or initial structuring of these products.

Most Non-Traditional ETFs “reset” daily, meaning that they are designed to achieve their stated objectives only on a daily basis. FINRA noted in its June 2009 Regulatory Notice that “[d]ue to the effect of compounding, their performance over longer periods of time can differ significantly from the performance . . . of their underlying index or benchmark during the same period of time.”<sup>2</sup> This effect can be magnified in volatile markets. For example, between December 1, 2008 and April 30, 2009, the Dow Jones U.S. Oil & Gas Index gained two percent, while an ETF seeking to deliver twice the index’s daily return fell six percent, and the related ETF seeking to deliver twice the inverse of the index’s daily return fell 26 percent.

Accordingly, investors were subjected to the risk that the performance of their investments in Non-Traditional ETFs could differ significantly from the performance of the underlying index or benchmark when held for longer periods of time, particularly in the volatile markets that existed during the Relevant Period.

#### Non-Traditional ETFs Have Dramatically Increased in Popularity Since 2006

In June 2006, a handful of Non-Traditional ETFs were listed and began trading on national securities exchanges after being registered with the U.S. Securities and Exchange Commission. Within nine months, over 40 additional Non-Traditional ETFs began trading on national securities exchanges. By April 2009, over 100 Non-Traditional ETFs were available in the marketplace, with total assets under management of approximately \$22 billion.

As the number of Non-Traditional ETFs grew, so did the number of transactions by customers at UBS FS. During the Relevant Period, UBS FS customers bought and sold a total of over \$4.5 billion of Non-Traditional ETFs.

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<sup>2</sup> Id. at 2.

**Certain UBS FS Customers Held Non-Traditional ETFs For Longer Periods of Time**

Despite the risks associated with holding Non-Traditional ETFs for longer periods, certain UBS FS customers held Non-Traditional ETFs for extended time periods during the Relevant Period. In fact, certain UBS FS customers with a primary conservative risk tolerance profile held Non-Traditional ETFs for periods of several months: For example:

- A 64-year old customer with a primary conservative risk tolerance profile and net worth of \$290,000 held a Non-Traditional ETF for 139 days in his IRA account and sustained losses of over \$5,700 (43% of his initial investment); and
- A 54-year old customer with a primary conservative risk tolerance profile and net worth of \$400,000 held a Non-Traditional ETF for 21 days and sustained losses of over \$5,000.

**UBS FS Failed to Establish and Maintain a Reasonable Supervisory System, including Written Procedures, in Violation of NASD Rules 3010 and 2110 and FINRA Rule 2010**

NASD Rule 3010(a) states in part that each member shall establish and maintain a system to supervise the activities of each registered representative, registered principal, and other associated person that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable NASD and FINRA Rules. Final responsibility for proper supervision shall rest with the member.

NASD Rule 3010(b)(1) states in part that each member shall establish, maintain, and enforce written procedures to supervise the types of business in which it engages and to supervise the activities of registered representatives, registered principals, and other associated persons that are reasonably designed to achieve compliance with applicable securities laws and regulations, and with the applicable NASD and FINRA Rules.

As described below, UBS FS violated NASD Rules 3010 and 2110 and FINRA Rule 2010<sup>3</sup> in that during the Relevant Period: (1) the Firm failed to establish and maintain a supervisory system, including written procedures, reasonably designed to achieve compliance with NASD and FINRA Rules in connection with the sale of Non-Traditional ETFs in accounts where the Firm provided brokerage services

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<sup>3</sup> For the period January 2008 to December 14, 2008, this conduct constitutes a violation of NASD Rule 2110, and for the period December 15, 2008 through June 30, 2009, this conduct constitutes a violation of FINRA Rule 2010, both of which require that a firm, in the conduct of its business, observe high standards of commercial honor and just and equitable principles of trade.

to certain retail customers; and (2) the Firm failed to provide adequate formal training and guidance to its registered representatives and supervisors regarding Non-Traditional ETFs.

**UBS FS Failed to Establish a Reasonable Supervisory System  
In Connection with the Sale of Non-Traditional ETFs**

The Firm supervised Non-Traditional ETFs the same way it supervised traditional ETFs until FINRA issued the Regulatory Notice in June 2009. The Firm relied on its general supervisory procedures to supervise transactions in Non-Traditional ETFs during the Relevant Period. However, the general supervisory system the Firm had in place during the Relevant Period was not sufficiently tailored to address the unique features and risks involved with these products. For example, during the Relevant Period, the Firm did not create a procedure to address the risks associated with longer-term holding periods in Non-Traditional ETFs. Thus, during the Relevant Period, the Firm failed to establish a supervisory system, including written supervisory procedures, reasonably designed to achieve compliance with applicable NASD and/or FINRA rules in connection with the sale of Non-Traditional ETFs.

**UBS FS Failed to Provide Adequate Training Regarding Non-Traditional ETFs**

Prior to June 2009, UBS FS failed to provide adequate formal training to registered representatives and supervisors regarding the features, risks, and characteristics of Non-Traditional ETFs. For example, prior to June 2009, the Firm failed to establish adequate guidance or tools to educate registered representatives and supervisors about Non-Traditional ETFs.

**UBS FS Made Unsuitable Recommendations,  
In Violation of NASD Rules 2310 and 2110 and FINRA Rule 2010**

The reasonable-basis suitability obligation under NASD Rule 2310 requires a broker-dealer and its registered representatives to, *inter alia*, perform reasonable diligence to understand the nature of a recommended security, as well as the potential risks and rewards. As FINRA recently stated, “[w]ith respect to leveraged and inverse ETFs, this means that a firm must understand the terms and features of the funds, including how they are designed to perform, how they achieve that objective and the impact that market volatility, the ETF’s use of leverage, and the customer’s intended holding period will have on their performance.”<sup>4</sup> In this case, UBS FS violated NASD Rules 2310 and 2110 and FINRA Rule 2010 by allowing its registered representatives to recommend to customers a Non-Traditional ETF without performing reasonable diligence to understand the risks and features associated with it.

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<sup>4</sup> See Notice 09-31, at 3; see also FINRA Regulatory Notice 12-03, *Complex Products – Heightened Supervision of Complex Product* (January 2012), at 5-6.

Certain UBS FS registered representatives made unsuitable recommendations of Non-Traditional ETFs to certain customers with a primary conservative risk tolerance profile, in further violation of NASD Rules 2310 and 2110 and FINRA Rule 2010.

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

1. Censure;
2. Fine in the amount of \$1.5 million; and
3. Restitution in the amount of \$431,488.

UBS FS agrees to pay the monetary sanctions upon notice that this AWC has been accepted and that such payments are due and payable. UBS FS has submitted an Election of Payment form showing the method by which the Firm proposes to pay the fine imposed.

UBS FS specifically and voluntarily waives any right to claim that it is unable to pay, now or at any time hereafter, the monetary sanctions imposed in this matter.

Restitution is ordered to be paid in the total amount of \$431,488. A registered principal on behalf of UBS FS shall submit satisfactory proof of payment of restitution or of reasonable and documented efforts undertaken to effect restitution. Such proof shall be submitted to Scott Andersen, Enforcement Director, Department of Enforcement, One World Financial Center, 200 Liberty Street, New York, NY 10281 either by letter that identifies UBS FS and the case number or by e-mail from a work-related account of the registered principal of UBS FS to [EnforcementNotice@FINRA.org](mailto:EnforcementNotice@FINRA.org). This proof shall be provided to the FINRA staff member listed above no later than 120 days after acceptance of the AWC.

If for any reason UBS FS cannot locate any customer identified in Attachment A after reasonable and documented efforts within 120 days from the date the AWC is accepted, or such additional period agreed to by a FINRA staff member in writing, UBS FS shall forward any undistributed restitution to the appropriate escheat, unclaimed property or abandoned property fund for the state in which the customer is last known to have resided. UBS FS shall provide satisfactory proof of such action to the FINRA staff member identified above and in the manner described above, within 14 days of forwarding the undistributed restitution to the appropriate state authority.

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.

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

## II.

### WAIVER OF PROCEDURAL RIGHTS

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

- A. To have a Complaint issued specifying the allegations against the Firm;
- 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 FS specifically and voluntarily waives any right to claim bias or prejudice 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 FS 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 FS 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 the Firm; and
- C. If accepted:
1. this AWC will become part of the Firm's permanent disciplinary record and may be considered in any future actions brought by FINRA or any other regulator against the Firm;
  2. this AWC will be made available through FINRA's public disclosure program in response to public inquiries about the Firm'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. the Firm 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 FS 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 the Firm's right to take legal or factual positions in litigation or other legal proceedings in which FINRA is not a party.
- D. UBS FS may attach a Corrective Action Statement to this AWC that is a statement of demonstrable corrective steps taken to prevent future misconduct. UBS FS 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 UBS FS, certifies 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 the Firm 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 the Firm to submit it.

\_\_\_\_\_  
Date (mm/dd/yyyy)

\_\_\_\_\_  
Respondent  
UBS Financial Services Inc.

By: \_\_\_\_\_

Title: \_\_\_\_\_

Reviewed by:

  
\_\_\_\_\_  
Ben A. Indek, Esq.  
Counsel for Respondent UBS Financial Services Inc.  
Morgan, Lewis & Bockius LLP  
101 Park Avenue  
New York, NY 10178-0600  
(212) 309-6109

By:   
\_\_\_\_\_  
Irene Marguaritt  
Managing Director  
4/20/12

Accepted by FINRA:

\_\_\_\_\_  
Date

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

\_\_\_\_\_  
Susan Light  
Senior Vice President and Chief Counsel  
FINRA Department of Enforcement  
One World Financial Center  
200 Liberty Street  
New York, NY 10281  
(646) 315-7333

April 20, 2012  
Date (mm/dd/yyyy)

Jonathan Eisenberg  
Respondent  
UBS Financial Services Inc.

By: Jonathan Eisenberg

Title: General Counsel

Reviewed by:

Ben A. Indek  
Ben A. Indek, Esq.  
Counsel for Respondent UBS Financial Services Inc.  
Morgan, Lewis & Bockius LLP  
101 Park Avenue  
New York, NY 10178-0600  
(212) 309-6109

Accepted by FINRA:

May 1, 2012  
Date

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

Susan Light  
Susan Light  
Senior Vice President and Chief Counsel  
FINRA Department of Enforcement  
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