

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER, AND CONSENT
NO. 2016050211701**

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

RE: UBS Securities LLC (Respondent)
Member Firm
CRD No. 7654

Pursuant to FINRA Rule 9216, Respondent UBS Securities LLC (UBS) 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 Respondent alleging violations based on the same factual findings described in this AWC.

**I.
ACCEPTANCE AND CONSENT**

A. Respondent accepts and consents to the following findings by FINRA without admitting or denying them:

BACKGROUND

UBS has been a FINRA member since 1978. UBS is headquartered in New York, New York, and operates more than 30 branch offices employing approximately 1,800 registered representatives. UBS provides investment banking, research, and securities trading to primarily institutional clients.¹

OVERVIEW

From 2009 to 2018, UBS violated Rule 204 of Regulation SHO and FINRA Rule 2010. First, for approximately three years, UBS improperly used revocable volume-weighted-average price (VWAP) transactions or limit orders to address buy-in obligations for failure-to-deliver positions, resulting in approximately 5,300 violations of Rule 204(a) and at least 71,000 violations of the penalty box and pre-borrow requirements of Rule 204(b). Second, for nearly seven years, when UBS released shares from segregation in connection with customer long sales, UBS erroneously considered those shares available to close out a fail-to-deliver, causing UBS to undercalculate the shares it was required to borrow or purchase to comply with Rule 204(a). Third, during various time periods from 2009 to 2016, four of UBS's order management systems did not restrict all short sales in securities with an unsatisfied close-out requirement, resulting in at least another 2,567 violations of Rule 204(b).

¹ For more information about the firm, including prior regulatory events, visit BrokerCheck® at www.finra.org/brokercheck.

From 2009 to August 2022, UBS also failed to establish and maintain a supervisory system, including written procedures, reasonably designed to achieve compliance with Rule 204 of Regulation SHO. UBS did not enforce its written supervisory procedures regarding Rule 204. UBS also failed to identify numerous red flags indicating that its close-out actions did not comply with Rule 204(a). Therefore, UBS violated NASD Rule 3010 and FINRA Rules 3110 and 2010.²

FACTS AND VIOLATIVE CONDUCT

This matter originated from an examination conducted by FINRA Member Supervision.

Rule 204 of Regulation SHO

The Securities and Exchange Commission adopted Regulation SHO to address concerns regarding persistent failures to deliver and potentially abusive “naked” short selling, *e.g.*, the sale of securities that an investor does not own or has not borrowed.

Accordingly, Rule 204(a) of Regulation SHO requires broker-dealers to take action to close out fail-to-deliver positions (fails or FTDs) resulting from short sales in equity securities by borrowing or purchasing securities of like kind and quantity by the beginning of regular trading hours on the settlement day following the settlement date.³

Broker-dealers may use VWAP transactions to purchase or “buy in” securities to close out a fail, provided that the VWAP order meets certain criteria, including that it is received by the beginning of regular trading hours on the applicable close-out date and is irrevocable. Limit orders or other delayed orders will not satisfy the close-out requirement.

When a fail is not closed out as required by Rule 204(a), Rule 204(b) of Regulation SHO prohibits the broker-dealer from engaging in short sales in the security without first borrowing or arranging to borrow the security, commonly known as the “penalty box” provision. The security remains in the “penalty box” and subject to the pre-borrow requirement until the broker-dealer purchases securities of like kind and quantity and the purchase clears and settles.

A violation of Rule 204 of Regulation SHO is also a violation of FINRA Rule 2010, which requires members to observe high standards of commercial honor and just and equitable principles of trade in the conduct of their business.

UBS Failed to Close Out FTDs

From 2008 to 2019, UBS used VWAP orders when purchasing shares to satisfy its Rule 204(a) close-out obligations. However, UBS reserved the right to cancel its VWAP

² FINRA Rule 3110 superseded NASD Rule 3010 on December 1, 2014.

³ Before September 5, 2017, for a short sale transaction in an equity security, Rule 204 required broker-dealers to take action to address FTDs by the beginning of regular trading hours on T+4 (trade date plus four business days). After September 5, 2017, Rule 204 requires broker-dealers to take action to address FTDs by the beginning of regular trading hours on T+3 (trade date plus three business days).

orders, and actually canceled 124 orders entered to buy in shares to close out an open fail between November 2015 and October 2018. In addition, during this time period, the firm's VWAP algorithm sent a limit order for the full size of the buy-in obligation to close out small-sized FTDs. The limit order issue affected approximately 10% to 15% of the firm's buy-in orders. By using revocable VWAP orders or limit orders to address FTDs, UBS failed to take effective close-out action as required by Rule 204(a) on approximately 5,300 occasions.

From 2009 until March 2016, UBS improperly considered shares released from segregation for customer long sales as shares available to reduce or satisfy its Rule 204(a) close-out obligations. This caused UBS to incorrectly assess its delivery and close-out obligations, including whether FTDs existed on that date and, if so, the number of shares it was required to borrow or purchase to close out the FTDs.

UBS's books and records did not enable it to assess the number of Rule 204(a) violations resulting from its inaccurate calculation of its delivery and close-out obligations.

Therefore, UBS violated Rule 204(a) of Regulation SHO and FINRA Rule 2010.

UBS Routed or Executed Short Sale Orders in Securities with an Open Fail

Each time that UBS purchased shares to address a FTD with a revocable VWAP or limit order as described above, the close-out did not comply with Rule 204(a). As a result, the equity securities should have been subject to the penalty box under Rule 204(b). However, UBS did not add those securities to its list of penalty box securities or otherwise restrict short sales in these securities. As a result, between 2016 and 2018, UBS routed or executed at least 71,000 short sales in securities for which it had an open FTD without first borrowing or arranging to borrow the shares as required by Rule 204(b).

Additionally, at various times between 2009 and 2016, three of UBS's order management systems were not configured to check the firm's penalty box list of securities and prohibit all short sales in these securities. For example, one of the order management systems checked the penalty box list for customer-side trades, but not for broker-dealer-side trades. During one month in 2016, following a routine update, a fourth order management system failed to monitor for and restrict trading in securities added to the penalty box list during the trading day. As a result, the four order management systems did not always restrict short sales in securities with an unsatisfied close-out requirement, resulting in another 2,567 violations of Rule 204(b) in July 2016.

Therefore, UBS violated Rule 204(b) of Regulation SHO and FINRA Rule 2010.

UBS Failed to Establish and Maintain a Supervisory System, Including Written Procedures, Reasonably Designed to Achieve Compliance with Rule 204

FINRA Rule 3110(a), and its predecessor NASD Rule 3010(a), require a member firm to establish and maintain a system to supervise the activities of each associated person that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable FINRA rules. FINRA Rule 3110(b), and its predecessor NASD Rule 3010(b), require a member firm to establish, maintain, and enforce written procedures to supervise the types of business in which it engages and the activities of its

associated persons that are reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable FINRA Rules.

A violation of FINRA Rule 3110 and NASD Rule 3010 is also a violation of FINRA Rule 2010.

From 2009 to August 2022, UBS's supervisory systems and written procedures (WSPs) were not reasonably designed to achieve compliance with Rule 204 of Regulation SHO.

UBS failed to identify numerous red flags that its VWAP algorithm sent close-out orders that did not comply with Rule 204(a). UBS recognized that its algorithm presented execution issues when used for small-sized share quantities and initially configured its close-out systems to avoid using its VWAP algorithm in such situations. When UBS later changed its Rule 204 close-out process to use its VWAP algorithm for all close-out actions, the firm did not conduct any review or testing of the VWAP programming. UBS also did not review its trade blotter or the VWAP executions, which reflected that the algorithm was routing small-sized buy-in orders as limit orders.⁴ As a result, UBS failed to identify that it used a limit order to effect approximately 10% to 15% of the firm's close-out actions from November 2015 to October 2018.

UBS amended its close-out process in October 2018 to require traders to effect buy-in orders by placing either a market-on-open order or a VWAP order for the full buy-in quantity with a third-party broker-dealer. However, UBS did not update its WSPs to reflect this change until February 2019. Until August 2022, UBS's WSPs still allowed the cancellation of VWAP orders entered to close out FTDs in limited circumstances.

From 2009 to 2016, UBS's systems and WSPs treated shares released from segregation in connection with a customer long sale as eligible for inclusion in its calculation of its delivery and close-out obligations. Although UBS conducted a review of its Rule 204 systems each year as part of its annual compliance testing, UBS did not detect that its improper treatment of shares associated with a customer long sale could lead to its undercalculating its delivery and close-out obligations as required by Rule 204(a) of Regulation SHO.

Since 2009, UBS's WSPs also provided that the firm's order management systems would enforce Rule 204(b)'s penalty box by blocking short sales of securities with FTDs. However, UBS failed to identify that the four order management systems did not comply with its WSPs until a system malfunction in 2016 caused the firm to review its order management systems for Rule 204 compliance. The programming flaws in two of the systems existed for six and seven years, respectively.

Therefore, UBS violated NASD Rule 3010 and FINRA Rules 3110 and 2010.

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

- a censure;

⁴ FINRA alerted the firm to its use of limit orders for close-out purposes in May 2017 after reviewing the firm's trade blotter and close-out executions.

- a \$2.5 million fine; and
- an undertaking requiring UBS to submit, within 90 days of the issuance of the Notice of Acceptance of this AWC, a certification in writing by one or more principal(s) and officer(s) of UBS with supervisory authority over the areas described in this AWC that, as of the date of the certification, the firm's supervisory systems and written procedures are reasonably designed to achieve compliance with Rule 204 of Regulation SHO. The certification should be submitted to Tiffany A. Buxton, Director, at tiffany.buxton@finra.org. All correspondence must identify the respondent and matter number 2016050211701. Upon written request showing good cause, FINRA staff may extend any of the deadlines related to the certification component of the sanction.

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

Respondent specifically and voluntarily waives any right to claim an inability to pay, now or at any time after the execution of this AWC, the monetary sanction imposed in this matter.

The sanctions imposed in this AWC shall be effective on a date set by FINRA.

II. **WAIVER OF PROCEDURAL RIGHTS**

Respondent 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, Respondent specifically and voluntarily waives any right to claim bias or prejudgment of the Chief Legal Officer, 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 its acceptance or rejection.

Respondent 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

Respondent 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 Respondent; and
- C. If accepted:
 - 1. this AWC will become part of Respondent's permanent disciplinary record and may be considered in any future action brought by FINRA or any other regulator against Respondent;
 - 2. this AWC will be made available through FINRA's public disclosure program in accordance with FINRA Rule 8313;
 - 3. FINRA may make a public announcement concerning this agreement and its subject matter in accordance with FINRA Rule 8313; and
 - 4. Respondent 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. Respondent 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 Respondent's right to take legal or factual positions in litigation or other legal proceedings in which FINRA is not a party. Nothing in this provision affects Respondent's testimonial obligations in any litigation or other legal proceedings.
- D. Respondent may attach a corrective action statement to this AWC that is a statement of demonstrable corrective steps taken to prevent future misconduct. Respondent 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.

The undersigned, on behalf of Respondent, certifies that a person duly authorized to act on Respondent's 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 Respondent has agreed to the AWC's

provisions voluntarily; and that no offer, threat, inducement, or promise of any kind, other than the terms set forth in this AWC and the prospect of avoiding the issuance of a complaint, has been made to induce Respondent to submit this AWC.

September 7, 2022

Date

Darya Geetter

UBS Securities LLC
Respondent

Print Name: Darya Geetter

Title: Managing Director, Head of US Regulatory Affairs

Reviewed by:



Elizabeth L. Mitchell
Stephanie Nicolas
Counsel for Respondent
Wilmer Cutler Pickering Hale and Door LLP
1875 Pennsylvania Avenue NW
Washington, DC 20006

Accepted by FINRA:

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

October 3, 2022

Date

Tiffany A. Buxton

Richard Chin, Chief Counsel
Tiffany A. Buxton, Director
FINRA, Department of Enforcement
Two Jericho Plaza, Suite 307
Jericho, New York 11753

Rebecca Carvalho, Senior Counsel
FINRA, Department of Enforcement
581 Main Street, 7th Floor
Woodbridge, New Jersey 07095