

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. 20060054507-01**

TO: Department of Enforcement
Financial Industry Regulatory Authority

RE: UBS Securities, LLC
CRD 7654

Pursuant to FINRA Rule 9216 of FINRA's Code of Procedure, Respondent, UBS Securities, LLC. ("UBS") submits this Letter of Acceptance, Waiver and Consent 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 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 Securities, LLC is a subsidiary of UBS AG and provides investment banking, asset management, and retail brokerage, among other services. The firm is headquartered in Stamford, CT.

OVERVIEW

UBS violated FINRA rules by failing to establish supervisory procedures and systems regarding the outsourcing of communications with its customers about the sale of securities that were reasonably designed to achieve compliance with NASD rules. In connection with the initial public offering of Vonage LLC ("Vonage") in May 2006, the activity of communicating with UBS customers who participated in a directed share program was outsourced to a Third Party Company, which developed a website to administer the directed share program. Although this activity involved communications with customers of UBS about the sale of securities from UBS to those customers, UBS failed to establish or maintain adequate systems or procedures to supervise the activity.

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The Third Party Company communicated with UBS customers through the website about certain aspects of the Vonage DSP. Certain UBS customers who visited the website were incorrectly informed that they had not been allocated shares in the IPO. By the time some of those customers learned several days later that they in fact had been allocated shares, the price of Vonage stock had declined significantly from the initial IPO price, yet those customers paid the higher IPO price for their shares.

UBS did not have adequate supervisory procedures or systems in place regarding the communications by the Third Party Company with its customers. For instance, UBS did not know what information had been communicated to the customers about their IPO allocations. UBS also did not take steps prior to the IPO to arrange for adequate access to the records or work product of the Third Party Company and failed to take steps prior to the IPO to require that the Third Party Company maintain and provide to UBS records of its communications with UBS's customers. As a result, when some customers complained that they had received incorrect information about their IPO allocations, UBS was unable to take effective action to address the problems. In fact, it was a number of months before UBS was able to learn the cause of the problem, when the Third Party Company reported the results of its investigation. Because of technological limitations of the website, the Third Party Company reported, the Third Party Company was unable to determine how many customers were affected, or what allocation information had been conveyed to certain customers.

As a result of the problems described above, UBS was unable to respond adequately to a number of customer complaints about allocations of shares in the Vonage DSP, and was unable to provide certain information to FINRA in response to investigative requests. This hampered FINRA's ability to investigate this matter.

As a result of UBS's failure to establish adequate supervisory procedures and systems for the outsourcing of communications with its customers about the sale of Vonage IPO securities in the directed share program, UBS violated NASD Rules 3010 and 2110.

FACTS AND VIOLATIVE CONDUCT

The Underwriting of the Vonage IPO

UBS was one of three lead underwriters for the initial public offering of 31,250,000 shares of common stock of Vonage on May 24, 2006. As part of the offering, 13.5 percent of the stock offered was reserved by Vonage for sale to approximately one million of its customers, in a directed share program ("DSP"). UBS sold approximately 1.2 million shares in the Vonage DSP and a total of 7,031,250 shares in the Vonage IPO. To participate in the DSP, eligible Vonage customers were required to open a limited-purpose brokerage account at one of the underwriters. Approximately 3,000 accounts were opened at UBS by customers to participate in the Vonage IPO through the DSP.

Shares sold pursuant to the DSP were purchased from Vonage by UBS and sold to customers through the accounts the customers had opened at the firm. UBS received

approximately \$1.5 million in compensation for its activities in connection with the Vonage DSP, including underwriting discounts and commissions for the sale of DSP shares. The underwriters collectively received approximately \$4 million for their activities in connection with the DSP.

Because of the large number of expected DSP participants, Vonage and the underwriters agreed that the DSP should be administered through an on-line, electronic platform. None of the underwriters had the requisite in-house technological ability to administer such a platform, so the Third Party Company was engaged to maintain the DSP website. Vonage contracted directly with the Third Party Company for its work on the DSP project, and UBS was not a party to that contract.¹ UBS agreed that most communications to DSP participants, including DSP participants who opened accounts with UBS, would be conducted through the website which was administered by the Third Party Company. These communications were to include the acceptance of offers, the provision of information about share allocations, and communications about money owed by the customers to UBS for their allocated shares.

UBS had written supervisory procedures for directed share programs. UBS's written supervisory procedures for DSPs, for example, required UBS teams participating in the programs to "prepare the packages to be sent out to the participants," "contact the participants to confirm receipt of documents and update the spreadsheet [of participants]" and "[o]n the night of pricing . . . call[] each of the individual participants and confirm[] with each of them directly whether or not they want their allocation[.]" However, UBS did not follow these procedures in connection with the Vonage DSP. UBS also had written supervisory procedures for outsourcing, but also did not follow those procedures in connection with the Vonage DSP.

The Vonage DSP Website

Eligible Vonage customers who wanted to purchase IPO shares through the DSP were required to use the Vonage DSP website. After opening a brokerage account at one of the three underwriters, eligible customers could submit conditional offers through the website to purchase at least 100 and no more than 5,000 shares from one of the underwriters. This conditional offer constituted an offer to purchase from the underwriters up to the number of shares of stock specified in the offer, at any price within the initial public offering range set forth on the Vonage DSP website. Upon the posting of an acceptance notice and share allocation to a customer's page on the Vonage DSP website, the underwriters would accept the customer's offer and the customer would be obligated to purchase the number of shares allocated at the IPO price.

The deadline for DSP participants to submit conditional offers for the Vonage DSP was May 19, 2006. After that date, customers were prohibited from making new conditional offers,

¹ The contract between the Third Party Company and Vonage contained a confidentiality provision that stated that "[e]ach party will keep all Confidential Information of the other party confidential and will not use any Confidential Information for any purpose other than in connection with this Agreement." The provision further provided that "[t]he receiving party shall disclose the other party's Confidential Information only to persons within the receiving party's organization having a need to know the information for the purpose of this Agreement."

although a customer could withdraw an existing conditional offer until it was accepted by the underwriter and shares were allocated to the customer.

The Vonage IPO

On May 23, 2006, the Securities and Exchange Commission declared Vonage's registration statement effective, and the price for shares in the IPO was set at \$17 a share. Conditional offers submitted by DSP participants were then accepted and the Third Party Company ran a computer program to determine IPO allocations that would be provided to DSP participants.

At approximately 5:24 p.m. on May 23, 2006, the "My Offer Summary" section of the main menu page, and the pricing page, of the Vonage DSP website were updated to include a line entitled "Your Allocation." At that point, the line included text, in red, which stated that "allocations have not been made." Participants were instructed to "check back soon."

At approximately 5:33 p.m., an e-mail was sent from the DSP website to Vonage DSP participants entitled "Vonage IPO Information: Pricing and Allocation Imminent." The e-mail stated that the registration statement had been declared effective and the IPO price had been determined. The email also advised participants that they could withdraw their conditional offer "until an acceptance notification is posted on the [DSP] website," which was "expected to occur shortly." Finally, the e-mail stated that "[t]he posting of an acceptance notification will constitute the underwriters' acceptance of your conditional offer."

At approximately 6:09 p.m., the Vonage DSP website was updated with a new message under the "Announcements" section on the summary page. The new message was entitled "Allocation Confirmation[.]" Under the "Allocation Confirmation" title, the website stated that the price for the IPO had been set, and it also advised users that if they were allocated shares, they would be required to pay the underwriter with which they opened a limited-purpose brokerage account within three business days. At that time, the "Your Allocation" line on the user's home page remained unchanged and stated that "allocations have not been made" and that users should "check back soon."

The Incorrect Allocation Messages

IPO Allocations were released to the DSP website at approximately 7:43 p.m. on May 23, 2006. Shares were allocated to approximately 11,613 different accounts. Over 1.2 million shares were allocated to the nearly 3,000 accounts that had been opened at UBS to participate in the IPO.

Once the allocations were released, DSP participants could see how many shares they had been allocated, and how much they owed for those shares, in the "Your Allocation" section of the website. This information was posted in red.

However, because of an error by the Third Party Company in disabling a server when the allocation program was run, some DSP participants whose offers to purchase shares had been

accepted saw messages on the website incorrectly stating that they had not been allocated any shares. DSP participants affected by this error saw a message incorrectly stating they had been allocated "0 shares at \$17" and that "You Owe: \$0."

At the time the share allocations were posted on the DSP website, UBS was also provided information about which of its customers had been allocated shares, how many shares those customers had been allocated, and how much the customers owed UBS for the shares. However, UBS did not begin to separately communicate this information to its customers until several days later, when letters confirming purchases were sent to all customers who had been allocated shares.

UBS Becomes Aware That Customers Are Affected

On the first day of trading of Vonage stock, May 24, 2006, the value of Vonage's shares declined from \$17 per share to \$14.85 per share. On the second day of trading, May 25, 2006, the price of the stock declined further and closed at \$13 per share.

By May 25, 2006, UBS was aware that three UBS customers had complained that they had been told they had not been allocated any IPO shares, when in fact they had received allocations. Shortly before noon on May 25, a UBS customer sent an e-mail to a UBS representative about "the complete fiasco that has been my experience with the Vonage IPO." In her e-mail, the customer reported that she had seen on the Vonage DSP website on May 23 that she had been allocated no shares but had then learned on the night of May 24 that she had been allocated 1,300 shares and owed \$22,100.00. According to the customer, she "did not watch what Vonage Holdings did in the market yesterday, 5/24/06, because I was TOLD by the Vonage website on the evening of 5/23/06 that I was not allocated any shares. None. ZERO." In her e-mail to the UBS representative, the customer attached her correspondence with another Vonage DSP customer who had similarly been incorrectly informed that he had not been allocated any shares.

In addition, later in the evening on May 25, a representative from another lead underwriter forwarded a customer's complaint to a representative from UBS. In the e-mail, the representative from the other underwriter stated that the Third Party Company had estimated that as many as 70 customers had seen the incorrect information stating that they had not received share allocations, and that "[t]hese 70 people may, therefore, not know they have allocations[, w]hich may be a good reason for making out-bound calls." The UBS representative responded that he "spoke to at least three people with this problem, and there may have been others who were not escalated to me." At 10:04 p.m., a representative from the third lead underwriter stated in an email to the UBS representative that she had seen discussions on Vonage forum message boards about customers receiving incorrect information regarding their share purchases.

Upon learning the information described above, UBS did not take sufficient action to determine the cause and extent of the dissemination of incorrect information to its customers through the website. For instance, UBS did not make calls to customers to determine if they saw incorrect allocation information on the VCDSP website or were harmed by relying on that incorrect information.

In fact, UBS did not know the cause of the incorrect information about share allocations on the Vonage DSP website and did not learn what had caused the problem until the Third Party Company's investigation was completed a number of months later. At that time, UBS learned that the incorrect allocation information was provided to certain customers as the result of a mistake by the Third Party Company. The Third Party Company reported to UBS that its investigation had revealed that an employee of the company had failed to reset one of the website servers.

UBS Violated NASD Rules 3010 and 2110 by Failing to Establish Adequate Supervisory Procedures or Systems for Outsourced Communications with Its Customers

NASD Rule 3010 requires firms to establish, maintain, and enforce supervisory systems, including written procedures, that are reasonably designed to achieve compliance with applicable securities laws and regulations.

Rule 3010 applies to activities undertaken by a member firm directly as well as those that are outsourced to third parties. As FINRA reminded firms in Notice to Members 05-48 ("Members' Responsibilities When Outsourcing Activities to Third-Party Providers)" issued in July 2005, "outsourcing an activity or function to a third party does not relieve members of their ultimate responsibility for compliance with all applicable federal securities laws and regulations and [FINRA] and MSRB rules regarding the outsourced activity or function." As noted in NTM 05-48, firms have a "continuing responsibility to oversee, supervise, and monitor the service provider's performance of covered activities" -- "functions that, if performed directly by members, would be required to be the subject of a supervisory system and written supervisory procedures pursuant to Rule 3010."

UBS allowed a third party to communicate with its customers through the Vonage DSP website about the sale of IPO shares to those customers through accounts at UBS. Those activities should have been subject to UBS's supervisory systems and procedures, even if performed on behalf of the firm by a third party. UBS failed, however, to establish or implement adequate supervisory procedures or systems regarding the activities of the Third Party Company in communicating with UBS customers about the sale of Vonage securities through the Vonage DSP website.

UBS also failed to respond adequately when it became aware that incorrect information about IPO allocations may have been provided to customers. When the zero allocation issue arose, UBS was unable to take effective action to address the problems that were caused by the provision of incorrect information. At the time, UBS did not know what allocation information had been communicated to its customers or how many customers may have been affected by the problem. UBS also failed to take steps prior to the IPO to require that the Third Party Company maintain sufficient records of its communications with UBS's customers about the IPO and IPO allocations. UBS did not, for example, require that the Third Party Company maintain copies of screenshots or other records that would have reflected statements made on the website to customers about IPO allocations. UBS also did not know, and could not promptly determine, the

cause of the problem, whether an error had occurred, and if so how to correct the error. UBS was therefore unable to investigate or remedy the problem or respond adequately to customer complaints. In fact, it was a number of months before UBS was able to learn the cause of the problem, when the Third Party Company reported the results of its investigation. Because of technological limitations of the website, the Third Party Company reported, the Third Party Company was unable to determine how many customers were affected, or what allocation information had been conveyed to certain customers.

Responding promptly to these problems was important because certain customers did not know for several days that they had received allocations of shares in the IPO. As a result, those customers may not have paid attention to the price of Vonage stock in the first few days of trading. By the time some of those customers later learned that they had been allocated shares, the price of Vonage stock had declined significantly from the IPO price. When those customers later sold their shares, they incurred losses

UBS also failed to ensure that FINRA had the same access to the work of the Third Party Company for UBS that FINRA would have had if UBS had performed the work directly.² For example, in its investigation, FINRA requested that employees of the Third Party Company testify under oath, in a transcribed interview, about the Vonage DSP and the process of allocating shares and communicating share allocation information to customers. However, the Third Party Company representatives provided only unsworn and untranscribed interviews, and UBS and the other lead underwriters were unable to arrange for employees of the Third Party Company to testify under oath, and in transcribed sessions, as requested by FINRA. In addition, FINRA requested that UBS provide certain information about the workings of the Vonage DSP website to assist in identifying customers who might have been provided incorrect information about share allocations. However, UBS was not able to provide that information or obtain it from the Third Party Company to provide it to FINRA without a confidentiality agreement, which was not acceptable to FINRA.

Based on the foregoing, UBS failed to establish and maintain supervisory procedures or systems regarding the outsourcing of communications with its customers that were reasonably designed to achieve compliance with NASD rules. As a result, UBS violated NASD Rules 3010 and 2110.

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

1. A censure.
2. A fine in the amount of \$150,000.

² See e.g., NTM 05-48, which states that "the member should ensure that [FINRA] and all other applicable regulators have the same complete access to the service provider's work for the member, as would be the case if the covered activities had been performed directly by the member." However, in this case, as noted above, a confidentiality agreement existed between the Third Party Company and Vonage concerning the Third Party Company's work in administering the Vonage DSP website.

3. (a) UBS shall pay restitution, in the amount of no more than approximately \$118,000, to no more than approximately 126 UBS customers, to compensate them for having been incorrectly told that they did not receive an allocation of shares in the Vonage IPO.

(b) UBS shall make restitution payments to UBS customers, as identified by FINRA, from the group specified in part (a) above, who received an allocation of shares in the Vonage IPO but were incorrectly told on the Vonage DSP website that they had not received such an allocation, provided that the customers did not otherwise learn they had been allocated shares in the IPO prior to the beginning of trading in Vonage on May 24, 2006. No payments shall be made to customers who did not pay for their shares and are not the subject of collection efforts. UBS shall make the payments to customers in accordance with the following procedures:

(i) FINRA will provide a list of eligible customers to UBS within 30 days of the issuance of this AWC. Within 30 days of receipt of that list, UBS shall provide FINRA with a proposed written notification and certification ("Notice") to be sent to these customers. Within 30 days after it receives approval of the Notice by FINRA, UBS shall send the Notice to all identified customers. The written notification and proposed certification shall be approved, prior to sending, by FINRA.

(ii) The Notice shall be sent to each eligible customer at the address(es) that the eligible customer used for the limited-purpose brokerage account opened at UBS for the Vonage DSP, unless UBS has knowledge of a more recent address(es) for the customer, in which case UBS shall send the written notification and certification to both that more recent address(es) and the address(es) used for the limited-purpose brokerage account. The notification shall request a written response within 60 days.

(iii) Within 60 days after the expiration of the 60-day period of part (ii) above, UBS shall make payments to the customers, in amounts as directed by FINRA. The amounts paid shall be the difference between (1) \$17 per share, and (2) the price of Vonage stock at the next opening or closing of the market after each customer learned from the Vonage DSP website of the allocation of IPO shares to that customer, multiplied by the number of shares allocated to each such customer, except that, for customers who did not log back in to the DSP website prior to 11:59 p.m. on May 25, 2006, the price of Vonage stock at the opening of trading on the following day shall be used.

(iv) Within 60 days of the completion of the restitution payments required by this AWC, UBS shall certify to FINRA that the payments have been made and shall provide FINRA with copies of checks or other documents

evidencing such payments. UBS shall also provide, at the same time, a schedule listing all customers UBS has paid pursuant to this AWC, stating the names of each customer and the amounts paid to each customer.

(v) UBS agrees to indemnify customers who meet the criteria set forth in paragraph 3(b)(i) but have not, as of the date of issuance of this AWC, paid for the Vonage shares allocated to them against future collection efforts by Vonage DSP, LLC, its affiliates, agents, or assignees, for the failure to pay for shares allocated to the customer as part of the Vonage DSP, in a form approved by FINRA.

4. Within 150 days of issuance of this AWC, a senior officer of UBS shall certify to FINRA that UBS has policies and procedures in place relating to outsourcing in connection with public offerings of common stock that are reasonably designed to achieve compliance with FINRA rules. At the time UBS provides this certification, UBS shall provide a written description of the policies and procedures that are the subject of the certification.

UBS specifically and voluntarily waives any right to claim that it is unable to pay, now or at any time hereafter, the monetary sanction imposed in this matter. The sanctions imposed herein shall be effective on a date set by FINRA staff.

II.

WAIVER OF PROCEDURAL RIGHTS

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

- A. To have a Formal Complaint issued specifying the allegations against the firm;
- B. To be notified of the Formal 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 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, 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 UBS;
 - 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.

UBS certifies that it 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.

August 4, 2009
Date

UBS Securities, LLC
Respondent

By: Alan J. Brudner

Alan J. Brudner
Managing Director
Region Americas Legal

Reviewed by:

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Counsel for Respondent

By: John Moon

John Moon
Director
Region Americas Legal

Accepted by FINRA:

Sept. 9, 2009
Date

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

A handwritten signature in black ink, reading "Thomas B. Lawson". The signature is written in a cursive style with a large, stylized "T" and "L".

Thomas B. Lawson
Chief Counsel
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