

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. 2007009401362**

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 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

In June 2009, UBS submitted an AWC in which the Firm was censured and fined \$100,000 for supervisory failures that allowed unsuitable short-term sales of closed-end funds ("CEFs") purchased at the funds' initial public offerings. Despite being aware that CEFs purchased at the initial public offering are most suitable for long-term investments and that short-term trading of these CEFs was generally unsuitable, UBS did not have a supervisory system and procedures in place 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 2009).

In April 2011, UBS submitted an AWC in which the Firm was censured, fined \$2.5 million, and agreed to pay \$8.25 million in restitution to certain clients who purchased 100% Principal Protection Notes issued by Lehman Brothers ("Lehman PPNs") during the time period March 17, 2008 through June 30, 2008 (the Relevant Time Period). Supervisory violations, which occurred during the Relevant Time Period, included failing to provide adequate training of FAs and to establish certain written supervisory procedures in connection with the marketing and sale of Lehman PPNs, particularly in light of market events during the relevant period, and failing to adequately analyze the suitability of sales of Lehman PPNs to certain UBS customers. Non-supervisory violations of NASD Rules 2110 (Just and Equitable Principles of Trade) and 2211 (Advertising) were also included. (FINRA Case #2008015443301) (April 2011).

OVERVIEW

During the period November 2004 through September 2006 (the "Relevant Period"), UBS violated Municipal Securities Rulemaking Board ("MSRB") Rule G-27, by failing to reasonably supervise certain cross-trading of municipal bonds by retail customers. The Firm lacked adequate policies and procedures to monitor this type of trading. In addition, the Firm failed to conduct adequate follow-up on red flags which put it on notice that one of its registered representatives, GF, may have been exercising discretion in customer accounts to engage in excessive and unsuitable cross-trading of municipal bonds. These red flags included multiple exception reports generated by the Firm's Compliance Department, indicating a possible pattern of improper short-term trading in municipal bonds for multiple customer accounts.

FACTS AND VIOLATIVE CONDUCT

MSRB Rule G-27 requires member firms to establish and maintain a system, including written procedures, to supervise the municipal securities activities of its employees, which is reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable MSRB rules. As shown below, during the Relevant Period, UBS lacked a reasonable system to supervise municipal bond cross-trades in the accounts of retail customers where those cross trades were solicited on both sides of the cross transaction by the same broker.

UBS employed GF as a registered representative in the Los Angeles branch office ("LA Branch") from January 2002 through September 2006. GF was a high-producing broker whose high net-worth clients often gave GF discretionary trading authority.

During the Relevant Period, GF exercised discretion to engage in short-term trading of municipal bonds for at least ten of these customer accounts. Many of these trades were suspicious as they resulted from cross-trades of municipal bonds between GF customer accounts, where GF solicited both sides of the trades. The Firm failed to reasonably supervise the cross-trading of municipal bonds because it lacked adequate policies and procedures to monitor this type of

trading. In addition, although UBS identified GF's trading as requiring further investigation, the Firm did not take sufficient steps to address the red flags. Because of these failures GF was able to engage in a pattern of excessive cross-trading during his time at UBS.

Firm Policies Regarding Cross-trades

During the Relevant Period, the Firm's policies regarding cross-trades were set forth in two UBS Compliance Bulletins. Compliance Bulletin 00-12 (entitled "Cross Transactions") applied to all cross-trades, and stated: "At least one side of the cross transaction must result from a bona fide unsolicited customer order."

An exception to this general policy was enunciated in UBS Compliance Bulletin 01-11 (entitled "Transactions in Taxable FI and Municipal Securities") which applied to taxable fixed income and municipal bond trades. This exception states that "FAs may solicit both sides of a cross transaction if such a cross would be beneficial to both clients."

The Firm provided no written or verbal guidance regarding what criteria should be utilized to determine whether a cross-trade is "beneficial to both clients," or who should make this determination. The standard to determine whether a cross-trade could be deemed "beneficial" to customers on both sides of a respective trade was unclear.

In the absence of adequate direction about how to apply this policy, the branch manager for the LA Branch, determined that cross-trades were beneficial on their face since neither party in the respective cross-trade would be charged the transactional fee normally associated with customer transactions. The branch manager for the LA Branch, however, never attempted to conduct any analysis of customer cross-trades beyond this assessment, and if he had, he could have determined certain of the cross-trading had economic benefit only to GF, and not to the retail customers.

GF's Trading is Flagged by the Firm

GF was engaged in a practice of frequent short-term transactions or in-and-out trading, often effected through cross-trading in municipal bonds that were intended for long-term holding. Although GF and the Firm earned transaction compensation on these trades, the transactions resulted in losses to certain customers.

During the Relevant Period, the Firm conducted annual audits of trading on the Firm's municipal bond trading desks, including the Western Region municipal bond trading desk located in Los Angeles, California ("the Los Angeles Municipal Bond Desk").

In 2004, Group Internal Audit ("GIA") conducted a review of the Los Angeles Municipal Bond Desk by scrutinizing one week of trading (the "GIA Audit"). GIA was part of the Firm's United States Wealth Management Group ("WMG"). The GIA Audit was one of GIA's regularly scheduled reviews of business units within WMG.

After completion of the GIA Audit, on November 7, 2004, GIA issued a Management Letter (the "Management Letter") addressed to three Firm managers: the branch manager for the LA Branch, as well as two senior managers of WMG.

The Management Letter identified deficiencies in supervision of municipal cross-trades on the Los Angeles Municipal Bond Desk. Among other things, it stated: "The audit included a review of activity of a Los Angeles Branch Financial Advisor [GF] who was conducting discretionary trades on a principal basis. Although permitted to conduct this activity, there were no supervisory controls in place to monitor the cross trading activity for appropriateness" (emphasis added).

The Management Letter further stated that "[s]pecific cross-trade activity by this FA has been referred to the Compliance Department." In accordance with this delegation of responsibility, Compliance assigned analysts to compile spreadsheets of cross-trading by GF.

The appendix to the Management Letter delegated various follow-up measures to Firm managers with a completion deadline of March 31, 2005:

- "Compliance should develop a surveillance report to identify cross-trade transactions for further review and action."
- "Branch Management should identify, review and approve cross trades for appropriateness."
- "Legal and Compliance should take appropriate action on this FA's trading activity."

Reviews of GF Cross-Trading

After the issuance of the Management Letter, Compliance conducted two reviews of GF's cross-trading and created spreadsheets identifying municipal bond cross-trades where both sides of the trades were marked as solicited. Both of these reviews were provided to the LA Branch management for their review by the Firm's Branch Group Control Officer assigned to act as a liaison on this matter ("the GCO"). The LA Branch managers, however, failed to adequately review these cross-trades for appropriateness.

The First Review

The first spreadsheet of GF cross-trades covered the second quarter of 2005 and consisted of a 17 page spreadsheet of GF cross-trades ("the First Review"). On June 24, 2005, the GCO sent the First Review to the LA Branch. The First Review was created by a compliance analyst, and comprised 153 GF customer cross-trades during the period April through June 2005.

Although the First Review was received by the LA Branch, the trades in the First Review were not reviewed or discussed with GF, and no action was taken with regard to them. The GCO did not follow-up on why no review was done.

The Second Review

On August 9, 2005, Compliance sent the GCO a narrative summary and a 28 page spreadsheet of additional GF cross-trades for the period June 17, 2005 through July 28, 2005 (the "Second Review"). The GCO in turn sent the narrative and Second Review to the branch manager for the LA Branch.

Among other things, the narrative accompanying the Second Review stated that it highlights six accounts involved in more than ten cross transactions for the period June 17, 2005 through July 28, 2005, and that "the majority of the sells involved for the cross-trades were held short-term and all six accounts had negative P/L from these transactions. (Not calculating any coupons)." The narrative also stated that "there were 19 instances in which discretion was exercised on both sides of the cross."

Despite multiple red flags raised by the Second Review, branch management for the LA Branch conducted only a cursory review of these cross-trades. First, only a portion of the trades were chosen for review. The branch manager for the LA Branch randomly selected twelve cross-trades from the Second Review. Second, when asked to explain these twelve cross-trades, GF stated that these trades were part of a bond swap strategy wherein municipal bonds were sold prior to maturity for a trading loss, and another municipal bond was subsequently purchased. The branch manager for the LA Branch, however accepted this explanation on its face without making any follow-up inquiries. For example, the branch manager never asked GF to identify what municipal bonds were subsequently purchased for the customer after the first bond was sold.

On or about September 19, 2005, the administrative manager for the LA Branch provided to the GCO, a summary of explanations advanced by GF regarding the 12 randomly selected cross-trades from the Second Review. The GCO made no further inquiries regarding any of the trades in the Second Review.

In September 2005, GIA closed the issues identified in the Management Letter, based on the GCO's representations that the matter was resolved in that GF's cross trading would be reviewed on a monthly basis. Although the Firm's Compliance Department continued to generate monthly reports for GF's cross-trading until December 2005, these exception reports were not provided to the LA Branch for review.

In December 2005, the Firm's Legal Department initiated yet another review of GF's cross-trading, but failed to take any action as to GF. This review was still pending when GF left the Firm in September 2006.

From approximately November 2004 through September 2006, UBS violated MSRB Rule G-27 by:

- a) Failing to reasonably supervise the cross-trading of municipal bonds executed for retail customers insofar as the Firm failed to establish and provide guidance or

specific procedures to ensure that fixed income cross-trades solicited on both sides of the cross transaction by the same broker, resulted in a benefit to both customers.

- b) Failing to conduct adequate follow-up on red flags which put it on notice that a registered representative may have been engaged in excessive and unsuitable cross-trading of municipal bonds.

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

- a. Censure,
- b. \$300,000 Fine

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.

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.

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, 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 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 the Firm to submit it.

UBS Financial Services Inc.

9/23/11
Date

By: [Signature]

Reviewed by:

9/23/11
Date

[Signature]
Eric Bernstein
Senior Associate General Counsel
UBS Financial Services, Inc.
Counsel for Respondent
Telephone: 212-882-5319

Accepted by FINRA:

9-30-11
Date

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

[Signature]
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