

NASD
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. CE3050009

TO: Department of Enforcement
NASD

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

Pursuant to Rule 9216 of NASD Code of Procedure, Respondent UBS Financial Services, Inc. ("UBS", the "firm" or "Respondent") submits this Letter of Acceptance, Waiver and Consent ("AWC") for the purpose of proposing a settlement of the alleged rule violations described in Part II below. This AWC is submitted on the condition that, if accepted, NASD will not bring any future actions against Respondent alleging violations based on the same factual findings.

Respondent understands that:

1. Submission of this AWC is voluntary and will not resolve this matter unless and until it has been reviewed and accepted by NASD's Department of Enforcement and National Adjudicatory Council ("NAC") Review Subcommittee or Office of Disciplinary Affairs ("ODA"), pursuant to NASD Rule 9216;
2. If this AWC is not accepted, its submission will not be used as evidence to prove any of the allegations against Respondent; and
3. If accepted:
 - a. this AWC will become part of Respondent's permanent disciplinary record and may be considered in any future actions brought by NASD or any other regulator against Respondent;
 - b. this AWC will be made available through NASD's public disclosure program in response to public inquiries about Respondent's disciplinary record;
 - c. NASD may make a public announcement concerning this agreement and the subject matter thereof in accordance with NASD Rule 8310 and IM-8310-2; and
 - d. 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 allegation in this AWC or create

the impression that the AWC is without factual basis. Nothing in this provision affects Respondent's testimonial obligations or right to take legal or factual positions in litigation or other legal proceedings in which NASD is not a party.

Respondent also understands that its experience in the securities industry and disciplinary history may be factors that will be considered in deciding whether to accept this AWC. That experience and history are as follows:

UBS, CRD# 8174, has been a registered broker-dealer and a member of NASD since 1936. Its principal offices are located in New York, New York. UBS engages in a full-service securities business and has approximately 11,700 registered persons and 499 active branch offices.

I.

WAIVER OF PROCEDURAL RIGHTS

Respondent specifically and voluntarily waives the following rights granted under NASD's Code of Procedure:

- A. To have a Formal Complaint issued specifying the allegations against it;
- 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 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 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.

Respondent further specifically and voluntarily waives any right to claim that a person violated the ex parte prohibitions of Rule 9143 or the separation of functions prohibitions of 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.

II.

ACCEPTANCE AND CONSENT

UBS hereby accepts and consents, without admitting or denying the allegations or findings, and solely for the purposes of this proceeding and any other proceeding brought by or on behalf of NASD, or to which NASD 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 NASD:

A. Summary

During the period January 2002 to December 2003 (the “relevant period”), UBS marketed and sold a non-proprietary managed futures product (“The Futures Fund”) to 4,491 investors (“the investors”), raising approximately \$202 million. The Futures Fund invested in commodities, including futures, options on futures, and forward contracts, and is a speculative investment that carries a high degree of risk.

UBS is required under NASD Rules to make recommendations and sales of this product only to customers for whom the investment is suitable. This includes an assessment of not only minimum net worth and income requirements as set forth in the prospectus and subscription agreement for the Futures Fund, but also a determination of the customer’s investment objectives, risk tolerance, other investments, and financial situation and needs. In addition, because of the inherent risks of investing in Direct Participation Plans, such as the Futures Fund,¹ NASD Rules also require the firm to maintain documents disclosing the basis upon which the determination of suitability was made as to each customer.

During the relevant period, UBS sold the Futures Fund to 14 customers for whom the investment was unsuitable because their investments exceeded the 10% maximum allowable percentage of net worth limitation set forth in the prospectus for the Futures Fund. In addition, UBS failed to maintain records disclosing the basis upon which its suitability determinations were made in its recommendations and sales to customers in the Futures Fund. UBS’s supervisory system and written procedures were not reasonably designed to provide for the maintenance of records disclosing the basis of those suitability determinations as required by NASD Rules.

In addition, UBS included advertisements on its website that failed to adequately disclose and describe the risks of investing in managed futures products in violation of NASD Rules.

¹ Because the Futures Fund involves the sale of limited partnership interests, they fall within the definition of “direct participation programs” or “DPPs” as defined in and governed by NASD Conduct Rule 2810, titled, “Direct Participation Programs.”

B. UBS's Marketing and Sale of the Futures Fund

UBS acts as the futures broker for the Futures Fund. The Futures Fund has a general partner and advisor which are not affiliated with UBS and which control the trading of commodity interests including futures, options on futures and forward contracts on behalf of the Futures Fund. The trading of commodity interests is speculative, volatile, and involves a high degree of leverage. A small change in the market price of a futures contract can produce major losses for the Futures Fund. The Futures Fund also has high fees, transaction costs and expenses relative to certain other products. According to the Futures Fund's prospectus, during the relevant period, the break-even level for investors to profit ranged from 4.6% to 7.1%.²

The Futures Fund is structured as a limited partnership and each investor purchases units of limited partnership interest ("Units"). These Units are relatively illiquid and no trading market exists for the Units. The Futures Fund, however, allows an investor to redeem his Units once a month, upon ten business days' written notice or at the discretion of the fund. This redemption amount is equal to the month-end net asset value minus a redemption fee for units held less than 12 months, which may be more or less than the original investment.

The Futures Fund is sold pursuant to a prospectus that sets forth certain minimum net worth and income requirements for investors. The prospectus requires each investor to have (i) a net worth of at least \$150,000 (exclusive of home, furnishings and automobiles), or (ii) a net worth of at least \$45,000 (exclusive of home, furnishings and automobiles) and an annual income of at least \$45,000, and (iii) that the investment not exceed 10% of the investor's net worth (exclusive of home, furnishings, and automobiles). Certain states also require that sales of the Futures Fund be limited to investors who meet certain more restrictive net worth and annual income requirements. The prospectus also enumerates the more restrictive investment requirements imposed by these states. Pursuant to UBS's procedures, prior to investing in a Futures Fund, each customer was required to receive the prospectus for the Futures Fund and to execute a subscription agreement representing that such customer met the minimum net worth and income requirements and the investment did not exceed the net worth limitation set forth in the prospectus.

² The break even level is determined by calculating Fund's fees minus estimated interest income. The June 29, 2001 prospectus estimated the Fund's fees to be 9.1% and interest income to be 4.5%. The March 28, 2002 prospectus estimated the Fund's fees to be 9.1% and interest income to be 2%. The December 27, 2002 prospectus estimated the Fund's fees to be 8.6% and interest income to be 2%.

Pursuant to each of the prospectuses filed during the review period, the breakdown of the approximately 8% brokerage fee is as follows: As the commodity broker, UBS receives 1% of assets under management in brokerage and transaction fees each year. The general partner receives 3% of assets under management each year (2% for advisory services and 1% for acting as the general partner). Finally, 4% is paid to the selling agents (the brokers) for services to the limited partners (the investors).

C. UBS Made Unsuitable Recommendations and Sales to 14 Customers in UBS's Futures Fund

During the relevant period, UBS made unsuitable investment recommendations to 14 customers in its Futures Fund. These 14 customers invested a total of \$1,425,600 in the Futures Fund. In each instance, the customer's investment in the Futures Fund exceeded the limitation set forth in the prospectus, which prohibited investments greater than 10% of a customer's net worth. Yet, even though each customer's investment exceeded the limitation set forth in the prospectus and was therefore unsuitable, in each of the 14 instances, a UBS financial advisor and branch manager signed an attestation, attached to the subscription agreement, attesting to the suitability of the sale.

Paragraph (b)(2) of NASD Conduct Rule 2810, entitled "Suitability," establishes the following standard of suitability applicable to DPPs:³

... In recommending to a participant the purchase ... of an interest in a direct participation program, a member ... shall: (i) have reasonable grounds to believe, on the basis of information obtained from the participant concerning his investment objectives, other investments, financial situation and needs, and any other information known by the member ... that: a. the participant is or will be in a financial position appropriate to enable him to realize to a significant extent the benefits described in the prospectus ...; b. the participant has a fair market net worth sufficient to sustain the risks inherent in the program, including loss of investment and lack of liquidity; and c. the program is otherwise suitable for the participant.

NASD's general suitability rule, NASD Conduct Rule 2310, also applies to the recommendation and sale of Futures Funds to investors.⁴ As a result, UBS violated NASD Conduct Rules 2810, 2310 and 2110 in its recommendation and sale of the Futures Funds to 14 customers.

D. UBS Failed to Maintain Records Disclosing the Basis Upon Which It Made Suitability Determinations

³ NASD Conduct Rule 2810(b)(2)(B)(i).

⁴ NASD Conduct Rule 2310 requires, among other things, that firms have reasonable grounds for believing that their investment recommendations are suitable for the customer on the basis of facts disclosed by the customer regarding his or her other security holdings, financial situation and needs.

In addition to the specific suitability assessment required by NASD Conduct Rule 2810(b)(2), as discussed above, NASD Conduct Rule 2810 imposes an additional, unique recordkeeping obligation that requires the firm to “maintain in the files of the member documents disclosing the basis upon which the determination of suitability was reached as to each participant.”⁵ NASD imposes this special recordkeeping requirement because of the unique tax status and investment characteristics, including restricted liquidity, of DPPs.⁶

UBS, in its recommendations and sales to the investors, did not meet the requirements of NASD Conduct Rule 2810(b)(2)(B)(ii). While UBS maintained a database of its customers, showing holdings in UBS accounts, investment objectives, net worth, income, and age of the customer, it is unclear whether each broker reviewed this information and made suitability assessments based on this information. For example, sales to 14 customers were made by brokers and approved by branch managers where the customers’ investment amounts, as set forth in the UBS database, exceeded the limitation delineated in the prospectus. In addition, although UBS’s database was updated when a new account was opened, it was not consistently updated at the time of sale of the Futures Fund and thus could not have provided the basis for a suitability determination in those instances where the information was outdated.

As a result, UBS failed to maintain records disclosing the basis upon which suitability determinations were made in its recommendations and sales to customers in the Futures Fund in violation of NASD Conduct Rules 2810, 3110, and 2110.

E. UBS Failed to Establish and Maintain an Adequate Supervisory System With Respect to the Maintenance of Records Disclosing the Basis for the Futures Fund Suitability Determinations.

UBS failed to establish and maintain an adequate supervisory system and written procedures reasonably designed to ensure that its registered representatives maintained the records disclosing the basis upon which the determination of suitability was reached for each customer’s investment in the Futures Fund, in violation of NASD Conduct Rules 3010 and 2110.

F. UBS Published on its Website Advertising Regarding Managed Futures Products Without Adequate Risk Disclosure in Violation of NASD’s Advertising Rules.

UBS published a generic advertisement on its website describing managed futures products. The advertisement, which did not discuss any specific security or product, stated that an investment in managed futures could help investors accomplish the

⁵ NASD Conduct Rule 2810(b)(2)(B)(ii).

⁶ SEC Release No. 34-23515, 1986 SEC LEXIS 1022 (August 7, 1986).

objective of balancing an investment strategy that attempts to capitalize on global marketplace opportunities.

The advertisement warned investors that managed futures funds “are speculative investments that are subject to a significant amount of market risk, and they are not suitable for all investors.” The advertisement, however, failed to adequately disclose and describe the substantial risks of investing in managed futures products, including but not limited to the following risks described in UBS’s prospectus for its Futures Fund:

- Performance can be volatile due to leveraged assets;
- An investor could lose all or a substantial amount of his investment in the fund;
- An investor’s ability to redeem units is limited and no secondary market exists for the units. An investor only may redeem units on a monthly basis;
- To break even, the Futures Fund must generate trading profits at least equal to the high fees, transaction costs, and expenses that they have relative to certain other kinds of investments and which reduce returns; and
- A substantial portion of the trades executed for the fund take place on foreign exchanges. No U.S. regulatory authority or exchange has the power to compel the enforcement of the rules of a foreign board of trades or any applicable foreign laws.

By failing to adequately disclose and describe the risks of investing in managed futures products on its website, UBS violated NASD Conduct Rules 2210(d)(1)(A) and 2110.

G. Sanctions

UBS consents to the imposition, at a maximum, of the following sanctions:

1. a censure; and
2. a fine in the amount of \$175,000.00.

Payment of the fine to NASD shall be made within 10 days of notice of acceptance of this AWC.

In addition, UBS shall comply with the following undertaking:

1. For those among the 14 customers, which are delineated by their initials in Exhibit A, who still hold Units in the Futures Fund:

UBS shall provide restitution to each such customer by paying an amount equal to any loss suffered by each such customer as follows: Within 30 days of the notice of issuance of this AWC, UBS shall prepare and forward to each such customer a letter (“Letter”), satisfactory to NASD, advising each such customer (i) of their

right to redeem their Units pursuant to and as more fully described in the prospectus for the Futures Fund, and (ii) that if they exercise their right to redeem their Units within 90 days of the date of the Letter and they incur any losses as a result of the redemption, then UBS shall reimburse them for any such losses, which shall equal the difference between the subscription amount and the redemption amount. Satisfactory proof of UBS's performance of this undertaking, or of reasonable and documented efforts undertaken to effectuate it, shall be provided to NASD staff no later than 120 days after acceptance of this AWC.

2. For another group of customers, UBS has incomplete records to enable it to determine if those customers exceeded the investment limitation regarding net worth, which is delineated in the prospectus. For this group of customers, UBS agrees to the following undertaking no later than 120 days after acceptance of this AWC:

a. UBS shall determine whether each customer's investment exceeded the net worth limitation set forth in the prospectus. This determination shall be made through a complete review of customer files on the corporate and branch level, followed by communication with those customers whose information cannot be verified by UBS.

b. Upon completion of the review, UBS shall provide NASD with written documentation demonstrating that this review has been completed for each customer and the results of the review.

c. UBS shall send the Letter and make the same restitution offer to those customers that exceeded the net worth limitation set forth in the prospectus as it shall make to the 14 clients referenced above. Any payment made to such clients shall be provided in the same manner in which it was provided to the 14 customers referenced above. Satisfactory proof of UBS's performance of this undertaking, or of reasonable and documented efforts undertaken to effectuate it, shall be provided to NASD staff.

III.

OTHER MATTERS

A. UBS understands that it may attach a Corrective Action Statement to this AWC that is a statement of demonstrable corrective steps taken to prevent future misconduct. It 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 NASD, nor does it reflect the views of NASD or its staff.

B. UBS agrees to pay any monetary sanctions imposed on it upon notice that

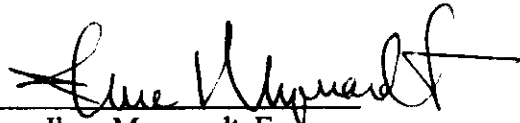
this AWC has been accepted and that such payments are due and payable, and has attached an Election of Payment form showing the method by which it proposes to pay any fine imposed.

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

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, and that no offer, threat, inducement, or promise of any kind, other than the terms set forth herein, has been made to induce UBS to submit it.

Respondent UBS Financial Services, Inc.,

Date: 4/20/05

By: 
Name: Ilene Marquardt, Esq.
Title: Senior Vice President and Deputy
General Counsel

Reviewed by:

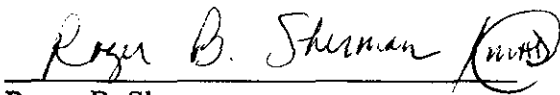


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Counsel for Respondent UBS Financial Services, Inc.

Accepted by NASD:

Date: 5/6/05



Roger B. Sherman
Senior Vice President and Director
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On behalf of the Director of the Office of
Disciplinary Affairs, by delegated authority