

NEW YORK STOCK EXCHANGE, INC.

EXCHANGE HEARING PANEL DECISION 03-98

June 4, 2003

UBS PAINWEBBER INCORPORATED
MEMBER ORGANIZATION

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Recommended and sold callable CDs which were unsuitable for certain customers, violated Exchange Rule 342(a) and (b) in that the Firm failed to establish and maintain appropriate procedures for supervision and control of the marketing and sales of callable CDs in certain specified respects, violated Exchange Rule 405(1) by failing to use due diligence to learn essential facts regarding certain customers, violated Exchange Rule 401 in that the Firm failed to adhere to the principles of good business practice in that it failed to communicate essential facts and make adequate disclosures to customers in trade confirmations and account statements relating to callable CDs – Consent to censure and fine of \$175,000.

Appearances:

For the Division of Enforcement
Virginia J. Harnisch, Esq.
Adeline Liu, Esq.

For the Respondent
Gerald F. Rath, Esq.

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An Exchange Hearing Panel met to consider a Stipulation of Facts and Consent to Penalty entered into between the Exchange's Division of Enforcement and UBS PaineWebber Incorporated (the "Firm"), a member organization. Without admitting or denying guilt, the Firm consented to a finding by the Hearing Panel that it:

- I. Engaged in conduct inconsistent with just and equitable principles of trade in that it recommended and sold Callable CDs, which were unsuitable for certain customers in view of the customers' ages, investment objectives, financial resources and concentration levels in their accounts.
- II. Violated Exchange Rule 342(a) and (b) in that the Firm failed to establish and maintain appropriate procedures for supervision and control of the marketing and sales of Callable CDs, by:
 - A. Failing to provide adequate training to all registered representatives with respect to Callable CDs;
 - B. Failing to ensure that marketing and sales were directed to prospective customers for which the product was suitable; and

- C. Failing to ensure that there was timely and adequate disclosure of the potential risks.
- III. Violated Exchange Rule 405(1) by failing to use due diligence to learn essential facts regarding certain customers.
- IV. Violated Exchange Rule 401 in that the Firm failed to adhere to the principles of good business practice in that it failed to communicate essential facts and make adequate disclosures to customers in trade confirmations and account statements relating to Callable CDs.

For the sole purpose of settling this disciplinary proceeding, the Division of Enforcement and the Firm stipulate to certain facts, the substance of which follows:

Background and Jurisdiction

1. The Firm is a member organization of the Exchange.
2. In 2000, UBS AG acquired PaineWebber Incorporated to form the Firm. The Firm adopted its present name in the same year. The Firm has its home office in Weehawken, New Jersey, and currently maintains more than 350 branches nationwide.
3. In or about March 2001, the Exchange initiated an investigation of the Firm's activities in marketing and selling long-term callable certificates of deposit.
4. In connection with that investigation, the Firm responded and provided information to the Exchange.

Overview

5. During the period June 1996 through February 2000 (the "Relevant Period"), the Firm engaged in unsuitable recommendations and sales of Callable CDs to certain customers. The Firm also lacked a reasonable system of supervision for the marketing and sale of Callable CDs, in that it failed to provide adequate training; failed to ensure that marketing and sales were directed to prospective customers for which the product was suitable; and failed to ensure timely and adequate risk disclosure to customers. In addition, the Firm did not exercise due diligence to learn essential facts about certain customers, and issued trade confirmations and account statements to customers which did not make adequate disclosures relating to Callable CDs.

Characteristics of Callable CDs

6. Callable CDs, like traditional bank CDs, are issued by a bank, insured by the Federal Deposit Insurance Corporation up to \$100,000, pay interest at a specified rate and at regular intervals, and carry a specific duration or maturity, at which time the full principal amount is to be returned to the investor.

7. Callable CDs differ from traditional bank CDs in several significant respects. While traditional bank CDs typically have maturities of between three months and ten years, the Callable CDs sold by the Firm were typically long-term investments, having maturities exceeding 10 years. Callable CDs may be sold prior to maturity date, but in such instances, the customer receives the prevailing price in the secondary market, which may be less than the purchase price. The Callable CDs contained a feature permitting them to be redeemed at their original face value upon the death of any holder.
8. Callable CDs have a call feature, that allows, but does not obligate, the issuer, or its successor in interest, to redeem the security after a specified period, typically 12, 18 or 24 months. Issuers will likely exercise their call option when interest rates fall, leaving the investor to reinvest funds at a lower rate of return. When the issuer exercises the call feature, the principal is returned to the investor in full.
9. In return for the uncertainty created by the call feature, Callable CDs offer to investors a rate of return that is higher than traditional bank CDs. However, this same uncertainty makes Callable CDs unsuitable investments for certain individuals with the investment objective of purchasing a fixed-income product that would return their principal investment at a date certain in the future.

The Firm's Training and Sales Program for Callable CDs

10. The Firm began marketing fixed-rate Callable CDs in the early 1990s with maturity periods ranging from 5 to 15 years. In June 1996, the Firm began marketing "stepdown CDs", a variation of Callable CDs, which pay an above-market interest rate for the initial year ("Stepdown Callable CDs"). Thereafter, the interest rate "steps down" to a predetermined lower rate for the duration of the maturity period. The Firm ceased its sales of the Stepdown Callable CDs in February 2000.
11. The Firm introduced Callable CDs and Stepdown CDs to its registered representatives ("RRs") through sales liaisons from its Taxable Fixed Income Department ("TFI"). These sales liaisons did not interact directly with Firm customers, but kept RRs apprised of products available to customers through TFI. Although the Firm gave formal training sessions to TFI sales liaisons regarding Callable CDs and Stepdown Callable CDs, the Firm lacked formal firm-wide training sessions for RRs during the Relevant Period.
12. Beginning in 1996, the Firm developed an "Investment Executive Guide to Certificates of Deposit" designed to educate RRs on the various types of CDs, including Callable CDs and Stepdown Callable CDs. Although the information contained in this publication was available to RRs in electronic format beginning in 1999, copies were not disseminated directly to all RRs who recommended Callable CDs.
13. In addition, the Firm developed various versions of a customer educational brochure on CDs which included a discussion of the features and risks of Callable CDs and

Stepdown Callable CDs. The Firm however did not require that every purchaser receive a copy of this brochure.

14. The Firm provided each Callable CD purchaser with a Certificate of Deposit Disclosure Statement (“Disclosure Statement”). While versions of this Disclosure Statement informed customers to varying degrees of the various risks associated with the purchase of Callable CDs and Stepdown Callable CDs, customers did not receive a copy of the Disclosure Statement until after their purchase when they received their trade confirmation.

Unsuitable Recommendations and Sales of Callable CDs

15. During the Relevant Period, certain RRs recommended and sold Callable CDs, including Stepdown Callable CDs, to customers which were unsuitable in view of the customers’ ages, investment objectives, investment experience, financial resources and the concentration levels of such Callable CDs in the customers’ accounts.
16. In certain instances, customer purchases were based upon recommendations of Firm RRs, which were unsuitable because the customers were of an age where an extended maturity period was not suitable. Some of these investors had a fixed income and limited investment experience. Certain of these investors also had an investment objective of safety of principal, and did not want to commit their principal for a lengthy period of time.
17. Certain customers complained to the Firm that some of the features of Callable CDs were confusing and that their RRs did not advise them that their return of principal could fall below the original purchase price if sold before the maturity date.
18. By early 2000, the Firm received complaints regarding Callable CDs or Stepdown Callable CDs from approximately 213 customers in more than 70 branches. Some of these customers were over age 70, and were seeking short-term, fixed income investments.

Failure to Adequately Supervise

19. Exchange Rule 342(a) requires, among other things, that “[e]ach office, department or business activity of a member organization shall be under the supervision and control of the member or member organization establishing it and of the personnel delegated such authority and responsibility.”
20. Exchange Rule 342(b) requires, in relevant part, that “each member organization shall provide for appropriate supervisory control and shall designate a general partner or principal executive officer to assume overall authority and responsibility for internal supervision and control of the organization and compliance with securities laws and regulations. This person shall: (1) delegate to qualified principals or employees responsibility and authority for supervision and control of each office, department or business activity, and provide for appropriate procedures of supervision and control [and] (2) establish a separate system of follow-up and review to determine that the

delegated authority and responsibility is being properly exercised.”

21. During the Relevant Period, as set forth below, the Firm violated Exchange Rules 342(a) and (b) in that the Firm lacked policies or procedures reasonably designed to ensure that RRs understood, and properly informed customers of, the features and risks of Callable CDs, including Stepdown Callable CDs.
22. In 1999, in at least two branch offices, branch management encouraged RRs (some of whom were inexperienced) to market Stepdown Callable CDs through telephone solicitations to prospective customers as a means of opening new accounts. The training provided to these RRs with respect to Callable CDs was inadequate. Among other things, they were not given adequate instruction on how to give proper risk disclosure to customers. Nor were they adequately instructed on how to ascertain the suitability of the product for the customer.
23. On certain occasions, RRs made misstatements or omitted material facts to prospective customers regarding the features of Callable CDs and Stepdown Callable CDs. For example, certain prospective customers were told that, after one year, they could liquidate their CD without risk of loss. These customers were not informed by the RRs that the market value of their CD could be less than the par value price at which they purchased it.

Failure to Learn Essential Facts Regarding Customers

24. Exchange Rule 405(1), in relevant part, requires every member organization to “[u]se due diligence to learn the essential facts relative to every customer, every order, every cash or margin account accepted or carried by such organization”
25. On certain occasions, the Firm, through its RRs, failed to take steps to ascertain whether prospective customers might require part or all of their principal invested in the CD at any time prior to the maturity date. Thus the Firm violated Rule 405(1) by failing to learn essential facts regarding customers who purchased Callable CDs and Stepdown Callable CDs.

Failure to Provide Adequate Disclosures on Account Documents and Trade Confirmations

26. Exchange Rule 401 requires every member organization to adhere to principles of good business practice in the conduct of its business affairs.
27. During the Relevant Period, the Firm violated Rule 401 by: a) failing to clearly explain to customers on the face of trade confirmations, the maturity period, the interest rates, the call feature and that the Firm was acting as a secondary market maker, and b) pricing Callable CDs at par value on customer account statements, without disclosing that par value was not the same as market value.

Corrective Action Taken

28. The Firm has informed Enforcement, and Enforcement has considered, the circumstances described below relating to the matters covered in the Stipulation and Consent.
29. Beginning in January 2001, the Firm began using a pricing model to provide approximate market value prices on customer account statements for Stepdown Callable CDs and other step-rate CDs. This pricing model was used for all of the Firm's Callable CD products beginning in October 2001.
30. In April 2001, the Firm issued an internal compliance bulletin to all RRs informing them that risk disclosure is required to all prospective purchasers of any long-term certificates of deposit prior to the time that an investment decision is made.
31. In 2003, the Firm implemented expanded training of RRs on Callable CDs. Among other things, the Firm provides specific training on this product in its broker-trainee program, and distributes copies of educational materials to newly-employed RRs.
32. The Firm is in the process of revising its trade confirmations to explain the maturity period, interest rates, call feature and the Firm's role in the secondary market with respect to Callable CDs. The Firm now provides such information in a supplemental document mailed to customers with their trade confirmation.
33. To date, the Firm has settled approximately 141 complaints, primarily relating to Stepdown Callable CDs, for a total of approximately \$ 650,000.

DECISION

The Hearing Panel, in accepting the Stipulation of Facts and Consent to Penalty, found the Firm guilty as set forth above by unanimous vote.

PENALTY

In view of the above findings, the Hearing Panel, by unanimous vote, imposed the penalty consented to by the Firm of a censure and a fine of \$175,000.

For the Hearing Panel

Vincent F. Murphy
Hearing Officer