

NEW YORK STOCK EXCHANGE, INC.

EXCHANGE HEARING PANEL DECISION 05-62

May 19, 2005

UBS SECURITIES LLC
MEMBER ORGANIZATION

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Violated Exchange Rule 440, Section 17(a)(1) of the Securities and Exchange Act of 1934 and Rule 17a-4 by failing to preserve for a period of three years, the first two of which in an accessible place, electronic communications relating to its business; and Violated Exchange Rule 342 by failing to reasonably supervise and control the activities of its employees and by failing to establish an adequate system of follow-up and review to ensure compliance with Exchange rules and federal securities laws relating to the retention of electronic communications – Consent to censure, a fine of \$2,100,000 and an undertaking.

Appearances:

For the Division of Enforcement
Linda S. Reifberg, Esq.
Suzanne R. Elovic, Esq.

For Respondent
Mitchell A. Lowenthal, Esq.
Alan Brudner, Esq.

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A Hearing Panel of the New York Stock Exchange, Inc. (“Exchange”) met to consider a Stipulation of Facts and Consent to Penalty entered into between the Exchange’s Division of Enforcement (“Enforcement”) and UBS Securities LLC (“Respondent” or the “Firm”), a member organization. Without admitting or denying guilt, Respondent consented to a finding by the Hearing Panel that it:

- I. Violated Exchange Rule 440, Section 17(a)(1) of the Securities and Exchange Act of 1934 and Rule 17a-4 by failing to preserve for a period of three years, the first two of which in an accessible place, electronic communications relating to its business; and
- II. Violated Exchange Rule 342 by failing to reasonably supervise and control the activities of its employees and by failing to establish an adequate system of follow-up and review to ensure compliance with Exchange rules and federal securities laws relating to the retention of electronic communications.

For the sole purpose of settling this disciplinary proceeding, the Division of Enforcement and Respondent, without admitting or denying the findings in the Stipulation of Facts and Consent to penalty stipulate to certain facts, the substance of which follows:

Background and Jurisdiction

1. Respondent became a member organization of the Exchange on September 6, 1985. It is principally owned by UBS AG (UBS AG was formed through the June 1998 merger of Union Bank of Switzerland with Swiss Bank Corporation) and is engaged in the business of global investment banking, securities trading, and asset management. The principal office of Respondent is located at 677 Washington Boulevard, in Stamford, Connecticut.
2. PaineWebber Inc. (“PaineWebber”), founded in 1879, was a full-service securities firm located in New York, and became a member of the Exchange on November 17, 1982. The services provided by PaineWebber, on a global basis, included investment banking, research, trading, investing on a principal basis, and asset management.
3. On November 3, 2000, UBS AG purchased PaineWebber and PaineWebber subsequently became known as UBS Financial Services, Inc. (“UBS Financial Services”). As part of the merger, PaineWebber banking and research activities were shifted to UBS Securities, and some investment bankers and research analysts previously employed by PaineWebber became employees of UBS Securities. Since the merger, UBS Financial Services is principally engaged in the business of servicing retail investors and no longer employs equity investment bankers or research analysts. UBS Financial Services’ principal office is located at 1285 Avenue of the Americas, New York, New York.
4. For purposes of this Consent, UBS Financial Services and Respondent will be collectively referred to as UBS, the Firm or the Respondent.
5. UBS Securities and UBS Financial Services are registered with the Exchange, the Securities and Exchange Commission (the “Commission”), NASD and with all 50 states, the District of Columbia and Puerto Rico.

Overview

6. This action concerns UBS’s violations of the record-keeping requirements of Section 17(a)(1) of the Securities Exchange Act of 1934 (the “Exchange Act”), Rule 17a-4 thereunder, and Exchange Rule 440 during the relevant period (January 1, 1999 through June 30, 2002). During that time, UBS failed to comply with the requirement that it preserve for three years, the first two of which in an accessible place, electronic communications relating to the Firm’s business as a broker, dealer and member of an exchange. In addition, UBS lacked adequate systems or procedures to ensure the preservation of electronic communications. The Exchange, the Commission, and NASD (collectively, the “regulators”) discovered these deficiencies during an inquiry into the Firm’s research and investment banking (“IB”) activities.

Non-Compliance with Books and Records Requirements

7. In April 2002, the regulators commenced an inquiry into the research and IB activities at UBS and other broker dealers during the period of July 1, 1999 to June 30, 2001 (the “Phase I inquiry”). During this time, employees at UBS used electronic communications to conduct business for the Firm as a broker, dealer and member of an exchange.
8. Pursuant to the Phase I inquiry, the regulators made multiple requests to UBS for electronic mail (“e-mail”) of research analysts and investment bankers. The Firm produced e-mail in response to these requests and subsequently indicated by letter that while the Firm had endeavored to provide all e-mail responsive to the regulators’ requests, UBS was not able to locate restorable back-up tape for the entire time period for every person whose e-mail had been requested. The Firm did not, at that time, indicate the scope or extent of e-mail that could not be restored or located. The communications and other information contained in the produced e-mail provided evidence that, among other things, the Firm had engaged in acts and practices that imposed conflicts of interest on research analysts.
9. In April 2003, the regulators initiated and settled joint enforcement actions against UBS and other broker dealers subject to the Phase I inquiry for various violations involving their research and IB activities. *See UBS Warburg LLC*, Hearing Panel Decision 03-070 (Apr. 22, 2003); *SEC v. UBS Warburg LLC*, Litigation Release No. 18112 (Apr. 28, 2003); and *UBS Warburg LLC*, NASD Letter of Acceptance Waiver and Consent No. CAF030022 (April 24, 2003).
10. In December of 2002, the Exchange commenced an inquiry into the incidence of “spinning” practices at UBS during the period of January 1, 1999 to June 2000 (the “spinning inquiry”). Spinning is the allocation of hot shares of initial public offerings (“IPO”) to executives of issuers in return for investment banking services.
11. Pursuant to the spinning inquiry, the Exchange made multiple requests to UBS for e-mail of registered representatives, branch office managers, investment bankers, and other supervisors. During the course of that inquiry, UBS produced e-mail responsive to the regulators’ requests, however the Firm failed to produce all of the e-mail requested.
12. In May 2003, the regulators commenced an inquiry into the supervision of the research and IB activities at UBS and other broker dealers during the period of July 1, 1999 to June 30, 2002 (the “Phase II inquiry”).
13. Pursuant to the Phase II inquiry, the regulators requested that the Firm produce e-mail for various supervisory personnel and other employees. The Firm produced certain e-mail in response to these requests.

14. In August 2003, in response to inquiries by the regulators, UBS stated that it had not been able to retain, locate and/or restore all of the e-mail for certain individuals.
15. The regulators then requested that UBS provide detailed information on the Firm's ability to locate and restore backup tapes containing e-mail responsive to the regulators' requests during the Phase I, Phase II, and spinning inquiries. In a series of responses, the Firm admitted that it had failed to retain, locate and/or restore all responsive e-mail requested during those inquiries and provided a detailed explanation of the circumstances leading to that failure.
16. UBS identified the following reasons for its failure to retain, locate and/or restore all responsive e-mail: certain backup tapes containing responsive e-mail of UBS employees could not be located; certain backup tapes containing responsive e-mail were located but did not contain e-mail, although a log had been generated indicating that the e-mail had been successfully backed-up; e-mail on certain backup tapes was corrupted and unreadable; certain backup tapes were re-cycled in violation of Firm policy so that the responsive e-mails had been taped over; certain tapes were mislabeled; and certain backup tapes from servers that had been located at PaineWebber facilities prior to the November 2000 merger of PaineWebber and UBS AG were never found.
17. During the relevant period, UBS had systems and procedures requiring the retention of certain electronic communications. However, those systems and procedures were inadequate to ensure that all electronic communications relating to the Firm's business were preserved for three years and for the first two years in an accessible place.

Section 17(a)(1) of the Exchange Act, Rule 17a-4, and Applicable Exchange Rules

18. Section 17(a)(1) of the Exchange Act provides that each member of a national securities exchange, broker or dealer "shall make and keep for prescribed periods such records, furnish copies thereof, and make and disseminate such reports as the Commission, by rule, prescribes as necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of this title."
19. The Commission has emphasized the importance of the records required by the rules as "the basic source documents" of a broker dealer. *Statement Regarding the Maintenance of Current Books and Records by Brokers and Dealers*, 4 SEC Docket 195 (April 6, 1974). The record-keeping rules are a "keystone of the surveillance of brokers and dealers by [Commission] staff and by the securities industry's self-regulatory bodies." *Edward J. Mawod & Co.*, 46 S.E.C. 865, 873 n. 39 (1977) (citation omitted), *aff'd sub. nom. Mawod & Co. v. SEC*, 591 F.2d 588 (10th Cir. 1979).
20. Pursuant to its authority under Section 17(a)(1), the Commission promulgated Rule 17a-4. Rule 17a-4(b)(4) requires UBS to "preserve for a period of not less than three years, the first two years in an easily accessible place ... [o]riginals of all

communications received and copies of all communications sent ... by such member, broker or dealer (including inter-office memoranda and communications) relating to [the firm's] business as such[.]” Rule 17a-4 is not by its terms limited to physical documents. The Commission has stated that internal electronic communications fall within the purview of Rule 17a-4 and that, for purposes of Rule 17a-4, “the content of the electronic communication is determinative” as to whether that communication is required to be retained and accessible. *Reporting Requirements for Brokers or Dealers under the Securities Exchange Act of 1934*, SEC Rel. No. 34-38245 (Feb. 5, 1997); *see also In re Janney Montgomery Scott LLC*, SEC Rel. No. 34-50272 (Aug. 25, 2004); *In the Matter of Robertson Stephens, Inc.*, SEC Rel. No. 34-47144 (Jan. 9, 2003); and *In the Matter of Deutsche Bank Securities, Inc., et al.*, SEC Rel. No. 34-46937 (Dec. 3, 2002).

21. Exchange Rule 440 requires that “every member organization shall make and preserve books and records as the Exchange may prescribe and as prescribed by Rule 17a-3. The record keeping format, medium and retention period shall comply with Rule 17a-4 under the Securities Exchange Act of 1934.”
22. Exchange Rule 342 requires that member organizations provide for appropriate supervisory control over every business activity to ensure compliance with Exchange rules and the federal securities laws, and this includes establishing a separate system of follow-up and review to ensure the proper exercise of authority and responsibility.
23. Based on the foregoing, UBS violated Section 17(a)(1) of the Exchange Act, Rule 17a-4 thereunder, and Exchange Rules 440 and 342 by failing to preserve electronic communications for three years and by failing to preserve electronic communications for the first two years in an accessible place.

DECISION

The Hearing Panel, in accepting the Stipulation of Facts and Consent to Penalty, found Respondent 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 Respondent of a censure and a fine in the amount of \$2,100,000. The amount paid to the Exchange by UBS Securities shall be reduced by \$700,000 pursuant to a civil money penalty paid to the Commission and by \$700,000 pursuant to a fine paid to NASD, in related proceedings. In addition, UBS Securities shall complete an appropriate undertaking to review its procedures regarding the preservation of electronic communications for compliance with Exchange rules and the federal securities laws. Within 90 days of the execution of the Stipulation and Consent, UBS Securities undertakes and agrees to inform the Exchange in writing that it has completed its review and that it has established systems and procedures in place reasonably designed to achieve compliance with those laws and rules concerning the preservation of electronic communications, including, but not limited to, all electronic communications that are sent and/or received through any platform or background IT

application. Enforcement shall have the discretion, upon a showing of good cause, to extend the deadline for compliance with the undertaking set forth in this paragraph.

For the Hearing Panel

Vincent F. Murphy – Hearing Officer

Panelists:

Richard H. Castro

Laurence A. Shadok