FINAL NOTICE

To: UBS AG

Of: 1 Curzon Street, London W1J 5UB

Dated: **5 August 2009**

TAKE NOTICE: the Financial Services Authority of 25 the North Colonnade, Canary Wharf, London E14 5HS ("the FSA") gives you final notice about a requirement to pay a financial penalty.

1. THE PENALTY

1.1. The FSA gave UBS AG ("UBS") a Decision Notice on 5 August 2009 which notified UBS that pursuant to section 206 of the Financial Services and Markets Act (the "Act"), the FSA had decided to impose a financial penalty of £8 million on UBS in respect of breaches of Principles 2 and 3 of the FSA's Principles for Business (the "Principles"). These breaches occurred between 1 January 2006 and 31 December 2007 ("the Relevant Period") in the international wealth management business conducted with non-UK resident clients in the London branch of UBS (the "London Branch").

1.2. UBS confirmed on 31 July 2009 that it will not be referring the matter to the Financial Services and Markets Tribunal.

1.3. Accordingly, for the reasons set out below and having agreed with UBS the facts and matters relied on, the FSA imposes a financial penalty on the firm in the amount of £8 million.

1.4. UBS agreed to settle at an early stage of the FSA's investigation. UBS, therefore, qualified for a Stage 2 discount under the FSA's executive settlement procedures. Were it not for this discount, the FSA would have imposed a financial penalty of £10 million on UBS.

2. REASONS FOR THE PROPOSED ACTION

Summary of conduct in issue

2.1. The FSA imposes a financial penalty on UBS for breaches of the Principles in relation to the systems and controls around the international wealth management business conducted from the London Branch during the Relevant Period. This Notice does not make any findings in relation to the domestic wealth management businesses conducted either via the London Branch or via UBS Wealth Management (UK) Limited.

2.2. During the Relevant Period, UBS breached Principle 2 by failing to conduct its international wealth management business from the London Branch with due skill, care and diligence and breached Principle 3 by failing to take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems.

2.3. These breaches became apparent when, as a result of concerns raised by an employee, UBS discovered that certain UBS employees on one desk in the international wealth management business had been involved in unauthorised foreign exchange and precious metals trading across 39 customer accounts during the Relevant Period (the "Unauthorised Trades"). The actions of these employees caused losses to customers who have since been compensated by UBS. To date, UBS has paid compensation in excess of USD 42.4 million to affected customers.

2.4. The Unauthorised Trades were concealed from customers (and from UBS itself), by the deliberate actions of employees who effected, amongst other things: (i) unauthorised internal transfers between the accounts of affected customers; (ii) the use of an internal "suspense" account; and (iii) the creation of unauthorised purported loans between affected clients.

2.5. During the Relevant Period, there was insufficient focus on the key risks associated with the London Branch's international wealth management business which dealt with international, high net-worth customers with sophisticated financial and wealth management needs.

2.6. In particular, in relation to the London Branch's international wealth management business, UBS failed to:

(a) adequately manage and control the key risks, and the level of risk, created by the international wealth management business model;

(b) provide an appropriate level of supervision over and challenge to customer-facing employees;

(c) challenge appropriately those in customer-facing and revenue-generating roles;

(d) produce management information sufficient to enable senior management to assess the effectiveness of controls designed to mitigate the key risks/level of risk; and

(e) implement effective remedial measures in response to several warning signs that occurred during the course of its business suggesting that the London Branch's international wealth management business' systems and controls were inadequate.

2.7. The FSA acknowledges that UBS has made changes to the systems and controls environment around its international wealth management business so as to correct the defects indentified herein. UBS commissioned a report by the same third party firm that conducted the Skilled Persons Report (as defined below) and this report concluded that (as at 30 June 2009), there have been *"very significant changes"* in the London Branch's international wealth management business and that "*the overarching control framework is adequate for the business as it is currently structured."*

3. STATUTORY AND REGULATORY PROVISIONS

3.1. The FSA is authorised, pursuant to section 206 of the Act, to impose a penalty of such amount as it considers appropriate in the circumstances, if it considers that an authorised person has contravened a requirement imposed on him by or under the Act.

3.2. Pursuant to section 2(2) and section 3 of the Act, one of the FSA's statutory objectives is maintaining confidence in the financial system.

3.3. Principle 2 of the Principles states that:

"A firm must conduct its business with due skill, care and diligence."

3.4. Principle 3 of the Principles states that:

"A firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems."

3.5. The FSA's approach to exercising its enforcement powers to impose a financial penalty on an authorised person is set out in the Enforcement Guide ("EG").

4. FACTS AND MATTERS RELIED ON

The UBS Business Model

Background

4.1. UBS is a major global financial group with its headquarters in Zurich. Amongst other businesses, UBS operates an international wealth management business, which focuses on providing wealth management services to individuals. Customers of UBS' international wealth management business may also gain access to the services of UBS' Investment Bank, including, amongst other things, services to trade in foreign exchange ("FX") and precious metals.

International Wealth Management Business

4.2. UBS conducts its international wealth management business in the United Kingdom through the London Branch.

4.3. The services UBS provides to its international wealth management customers in the UK include, amongst other things: bank account services; investment advisory services; portfolio management (i.e. the discretionary management of a portfolio of cash and investments in accordance with investment guidelines); the execution of trades on customer instructions; and the safekeeping of documents and assets. International wealth management customers are typically non-UK resident individuals who have substantial assets to invest, and are sophisticated, active and performance-driven investors.

4.4. The international wealth management business conducted from the London Branch operated from seven desks in the Relevant Period. Each focused on non-UK resident customers from different geographic areas (the "International Business Desks"). Every International Business Desk had its own portfolio of customers and was led and managed by a Desk Head.

4.5. Each international wealth management customer was allocated to a particular Client Adviser. The Client Advisers had day-to-day contact with customers, executed customer orders, provided advice and made recommendations in relation to investments and other products and services where relevant.

Desk Heads

4.6. The London Branch's international wealth management business model afforded the Desk Heads a high degree of autonomy and authority. Each Desk Head supervised the Client Advisers operating on that specific International Business Desk. Desk Heads' responsibilities included preparing investment documentation, contributing to technical discussions and liaising with Legal, Compliance and 'Back Office' functions. Where appropriate, Desk Heads were also expected to meet clients with the Client Advisers.

4.7. During the Relevant Period, the Desk Heads in the international wealth management business had dual reporting lines: each Desk Head reported to a senior manager (based within the UK) as well as their respective regional market head (often based in locations outside of the UK).

4.8. Desk Heads could be promoted into the role from the position of Client Adviser. Upon promotion, UBS encouraged Desk Heads to relinquish their customer relationships; however, UBS did not insist that they did so. Where Desk Heads retained customer relationships, a senior manager was expected to perform the Desk Head role in relation to those customer relationships that the Desk Head had retained.

Client Advisers

4.9. Client Advisers were responsible for managing UBS' overall relationship with its customers. Client Advisers acted as the primary point of contact for UBS' customers and were responsible for managing and investing customers' wealth.

4.10. Client Advisers were expected to market services to customers who had an existing relationship with UBS. They were also expected to source new customers.

The Control Environment

4.11. Client Advisers worked in the 'Front Office' of the London Brach. The Front Office was responsible for dealing with and providing services to international wealth management customers. In addition, the London Branch had an independent operations function (or 'Back Office') which provided settlement, payments, valuation and pricing services to the international wealth management business.

4.12. During the Relevant Period, UBS' control framework was designed to operate on the basis of a 'Three Lines of Defence' model. UBS considered that the 'First Line of Defence' was the business itself; that is, the Client Advisers and Desk Heads. UBS considered the 'Second Line of Defence' to be UBS' Risk and Compliance department, which, amongst other things, undertook monitoring and risk assessments. For the 'Third Line of Defence', UBS relied upon its Group Internal Audit function and external auditors.

Identification of the Issues

4.13. On 31 December 2007, a UBS employee reported to UBS' Money Laundering Reporting Officer a concern regarding a proposed transfer of funds from an international wealth management customer's account to a particular Desk Head's ("Desk Head 'A'") personal account. As a result, the Risk & Compliance department announced it would undertake a review of the International Business Desk headed by Desk Head 'A' ("Desk X"). The announcement of this review prompted another employee on Desk X to escalate a concern regarding an unauthorised inter-customer transfer of a structured product at a non-market price.

4.14. In response to these concerns, UBS suspended relevant employees on the Desk and conducted a comprehensive investigation. The investigation established that Desk Head 'A' and certain other employees on Desk X had engaged in and/or facilitated unauthorised foreign exchange ("FX") and precious metals transactions by using certain international wealth management customers' money without their authorisation and allocating any resulting profit or loss to the affected customers' accounts. There was a high volume of FX transactions during the Relevant Period; UBS' investigation identified approximately 50 such trades per day during 2006, which continued (at a reduced rate) throughout 2007.

4.15. UBS' investigation established that losses arising from the Unauthorised Trades were allocated to the accounts of other affected customers on the same Desk by exploiting the following failings in the control environment that operated in the international wealth management business:

(a) FX transactions could be executed by providing UBS' FX traders with only an identifier for the trade and the details of the amount and the currency to be traded. Full details of the transaction, including the account number, could be provided to UBS' FX traders up to 24 hours later. This allowed the performance of the trade to be assessed before Desk Head 'A' decided how any losses (or profits) should be allocated;

(b) FX trades that had already been executed and booked could be cancelled and then subsequently re-booked onto another customer's account; and

(c) FX trades made nominally on behalf of a number of customers could be consolidated into a single trade with an 'averaged' price, thereby hiding the number of deals and the patterns of price.

4.16. UBS' investigation identified that losses resulting from the Unauthorised Trades were concealed by Desk Head 'A' and certain other individuals on Desk X from UBS' customers by adopting the following techniques:

(a) unauthorised transactions were made on the accounts of customers on the Desk who utilised UBS' 'retained mail' facility. Customers using the 'retained mail' facility did not receive timely statements and updates on their accounts; as such, it was less likely that such customers would discover in a timely way the unauthorised activities on their accounts in comparison to those customers receiving periodic statements;

(b) customers with significant liquid funds in their accounts were persuaded by the Desk to "lend" funds to other customers on the Desk who had incurred losses as a result of the Unauthorised Trades. These "loans" were documented on UBS headed notepaper by way of purported 'UBS Guarantee Letters'. This procedure was intended by the employees on Desk X to give the lending customers the impression that the loan had been approved by UBS; however, no such approval had been given; and

(c) a number of internal transfers were routed inappropriately through one of UBS' internal 'suspense' accounts. The use of the suspense account enabled the true origin of the funds to be concealed as the source would not be displayed on the customers' statements.

4.17. Desk Head 'A' and other individuals working on Desk X were able to deploy these techniques without effective challenge from UBS' systems and controls.

4.18. UBS reported the findings of its investigation to the FSA on 30 January 2008. In February 2008, UBS commissioned an independent third party to assist it in identifying those customers who had been affected by the Unauthorised Trades. This work identified that 39 clients of "Desk X" had been affected by the Unauthorised Trades.

Section 166 Review and Key Findings

4.19. On 7 May 2008, the FSA issued UBS with a requirement notice (the "Notice") in accordance with section 166 of the Act. The Notice required UBS to appoint a Skilled Person to provide the FSA with a report (the "Report") on the control environment for the International Business Desks operating from the London Branch of UBS.

4.20. The Notice requested the Skilled Person to consider the extent to which the UBS employees on Desk X had evaded the systems and control at UBS in order to undertake the Unauthorised Trades and then conceal and allocate the losses using the methods set out at 4.15 to 4.16(c) above.

4.21. The Report concluded that the control environment within the London Branch's international wealth management business was not adequate throughout the Relevant Period and that the relevant UBS employees were able to conceal losses without challenge from any relevant controls.

4.22. The Report also noted, in relation to the controls around Desk X, that:

(a) there was a lack of preventative controls (i.e. controls designed to prevent risks from crystallising);

(b) UBS' international wealth management business model placed significant reliance on the honesty of its employees and the supervisory obligations of Desk Heads without taking steps to mitigate against the risk that employees (including senior employees such as Desk Heads) would act incompetently or dishonestly;

(c) many clients on the desk had elected to use the 'retained mail' facility and as a result it was unlikely that such customers would detect errors or fraud themselves;

(d) there were inadequate controls over the cash withdrawal process;

(e) there were inadequate preventative controls to ensure that transactions were undertaken in accordance with the terms of a client mandate. This meant that a Client Adviser could accept a client instruction and execute the trade without an independent check or review;

(f) prior to the introduction of automated payments systems in October 2007, there were ineffective controls to prevent or detect the transfer of funds from an international wealth management client account to the general suspense account or to review the suspense account for unusual transactions matched intra-day; and

(g) there were ineffective controls over 'retained mail'. In particular, when international wealth management customers collected their mail, UBS' employees were not required to prepare a checklist of all documents received by the client or to obtain a signed receipt.

4.23. UBS informed the Skilled Person that the controls around Desk X were the same controls as those in place around the other International Business Desks within the London Branch during the Relevant Period.

Analysis of Breaches

4.24. UBS' breaches of the Principles can be grouped into two separate categories:

(a) Breaches of Principle 3 (risk management systems and control); and

(b) Breaches of Principle 2 (due skill, care and diligence).

<u>Principle 3 (risk management systems and control)</u>

4.25. Principle 3 required UBS to establish and maintain such systems and controls as were appropriate to its business. As set out in more detail at 4.1 to 4.12 above, UBS' international wealth management business model included three material factors which UBS was obliged to consider when designing its systems and controls:

(a) the London Branch's international wealth management business dealt with international, high net worth customers with sophisticated financial and wealth management needs;

(b) the Desk Heads had significant autonomy and authority; and

(c) UBS was undergoing a period of substantial growth in relation to its international wealth management business and accordingly, financial performance of employees was a material factor in assessing their remuneration, in particular discretionary annual bonuses for Desk Heads and Client Advisers. This created a tension between employees' personal interests and their risk and compliance obligations. This tension needed to be appropriately managed.

4.26. By reason of the facts and matters set out below, the FSA considers that UBS breached the requirements of Principle 3 by failing to put in place systems and controls in the international wealth management business conducted in London Branch sufficient to mitigate the risk that its employees would undertake unauthorised financial transactions without customer instructions or, where such transactions were made, to detect the transactions in a timely manner. To the extent that UBS had systems and controls in place to prevent or detect unauthorised financial transactions, UBS failed to ensure that such systems and controls were fully complied with and implemented in the business. In addition, where such failures were identified, UBS did not remedy such failures in a timely or effective manner.

4.27. The following failings were specifically identified or reflected in the Report. The FSA concurs with the principal findings of the Report and considers that these failings constitute a breach of Principle 3.

Organisation and Control

(a) The management reporting structure of the international wealth management business was complex and this, in conjunction with the dual management oversight and supervision of Desk Heads, failed to provide clear ownership of responsibilities or procedures for the escalation of issues.

(b) There was insufficient segregation of duties in the Front Office.

(c) During the Relevant Period the Front Office was able to input, change and approve FX trades with no effective challenge from the Back Office;

(d) Until the middle of 2007, the Back Office operated in a silo manner, with little or no cross-functional activity; and

(e) The 'Training and Competency' scheme was incomplete, and failed to cover all the required business areas. In particular, there was no formal, documented Training and Competency scheme for the Back Office.

Policies and Procedures

(f) The Front and Back Offices, including the Front Office Risk Monitoring team, did not have a clearly defined and documented set of procedures;

(g) The Desk Head Supervision Manual did not contain sufficient guidance to Desk Heads regarding the evidence that should be retained to demonstrate that a control had been performed;

(h) The business model relied upon Desk Heads relinquishing their customer relationships upon promotion from Client Adviser, in order to allow the Desk Heads to concentrate on supervisory responsibilities. This did not happen on Desk X; and

(i) Where Desk Heads retained customer relationships, the business model required a senior manager to act as the Desk Head in respect of those customer relationships. In practice, this did not happen.

Desk Head and Team Head controls

(j) A significant number of the Desk Head and Team Head controls were not performed in practice in the international wealth management business during the Relevant Period.

Management information

(k) During the Relevant Period, the predominant focus of the Front Office management information was on financial performance, rather than risk management, compliance or the training and competence of staff.

FSA Registration of employees

(l) UBS failed to register a change to the senior management of the international wealth management business so that their FSA control functions corresponded with the activities they were performing. The FSA considers that this conduct is very serious.

Conclusion

4.28. For the reasons above, the FSA considers that in its operation of the international wealth management business in the London Branch, UBS was in breach of Principle 3 during the Relevant Period, in that it:

(1) Failed to take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems.

(2) Failed to take reasonable care to establish and maintain systems and controls that were appropriate to that business.

(3) Failed to take reasonable care to establish and maintain effective systems and controls for compliance with applicable requirements and standards under the regulatory system and for countering the risk that customers of the firm might be affected by employee misfeasance.

<u>Principle 2 (due skill, care and diligence)</u>

4.29. By reason of the facts and matters detailed below, the FSA considers that UBS failed to act with due skill, care and diligence during the Relevant Period in that its systems were inadequate and not being implemented appropriately in breach of Principle 2.

4.30. The following failings were specifically identified or reflected in the Report. The FSA concurs with the principal findings of the Report and the FSA considers that these failings constitute a breach of Principle 2.

Compliance Monitoring and Internal Audit

(a) UBS' compliance monitoring of the international wealth management business in the Relevant Period was focused on Desk-Based reviews which lacked depth and a robust risk assessment process. The monitoring had limited impact on identifying and improving the control framework;

(b) UBS' risk and compliance functions were perceived by the Front Office to 'own' issues relating to risk and control, rather than responsibility and accountability being accepted by the Front Office and/or Back Office;

(c) Some significant recommendations from Group Internal Audit reports relating to the international wealth management business were not implemented by management in a timely manner; and

(d) Insufficient supervision and the inadequate control of certain activities within the international wealth management business, most notably FX trading as described above, made it harder to detect unauthorised activities on a timely basis.

Due Regard to Warning Signs

(e) UBS also failed to pay proper regard to several warning signs that occurred during the course of its business which should have led UBS management to consider the extent to which its systems and controls were appropriate.

Conclusion

4.31. For the reasons above, the FSA considers that UBS was in breach of Principle 2 during the Relevant Period, as it failed to conduct its business with due skill, care and diligence.

5. <u>ANALYSIS OF PROPOSED SANCTION</u>

5.1. The FSA's policy on the imposition of financial penalties and public censures is set out in the FSA's Decision Procedure & Penalties manual (DEPP) and EG. In determining the financial penalty proposed, the FSA has had regard to this guidance. The FSA has also had regard to the provisions of the FSA's Enforcement manual (ENF) which were in force during the first part of the Relevant Period.

5.2. The principal purpose of a financial penalty is to promote high standards of regulatory conduct by deterring firms who have breached regulatory requirements from committing further contraventions, helping to deter other firms from committing contraventions and demonstrating generally to firms the benefit of compliant behaviour.

5.3. For the reasons set out above, the FSA considers that UBS breached Principles 2 and 3 during the Relevant Period in relation to the operation of its international wealth management business. In determining that the financial penalty is appropriate and proportionate in this case, the FSA has considered all the relevant circumstances. The FSA considers the following factors to be particularly important:

(1) Deterrence (DEPP 6.5.2(1))

A substantial financial penalty is required to strengthen the message to the industry that firms must pay due regard to the interests of their customers when designing their systems and controls environment and that firms must have in place appropriate systems and controls to mitigate against the risk that customers will be disadvantaged by misconduct or crime by a firm's own employees. Whilst the FSA accepts that individuals may seek to circumvent systems and controls in order to perpetrate misconduct, it is imperative that firms take reasonable steps to identify the risk, and to ensure that it is appropriately mitigated.

(2) Seriousness and impact of the breach (DEPP 6.5.2(2))

The FSA has had regard to the seriousness of the breaches, including the nature of the requirements breached, the number of and duration of the breaches, the number of customers who were exposed to the risk of loss and who actually suffered loss, and whether the breaches revealed serious weaknesses of the management systems or internal controls. For the reasons set out above, the FSA considers that UBS' weaknesses exposed international wealth management customers to an unacceptable risk that they would be disadvantaged by virtue of their dealings with UBS.

The FSA has had regard to the fact that the clients of Desk X indentified as affected by the Unauthorised Trades have been compensated by UBS.

(3) The extent to which the breach was deliberate or reckless (DEPP 6.5.2(3))

The FSA does not consider that UBS committed the breaches deliberately or recklessly.

(4) The size, financial resources and other circumstances of the firm (DEPP 6.5.2(5))

UBS is a substantial global bank with a significant brand presence in wealth management. In deciding on the level of penalty, the FSA has had regard to the size of the financial resources of UBS. UBS is a major financial institution and must put in place systems and controls commensurate with the requirement to adequately supervise a complex, profitable, global business with a high level of risk. In addition, the FSA has had regard to the importance of reputation in the international wealth management business.

The FSA has no evidence to suggest that UBS is unable to pay the financial penalty.

(5) The amount of profits accrued or the loss avoided (DEPP 6.5.2(6))

UBS did not profit from the breaches.

(6) Conduct following the breach (DEPP 6.5.2(8))

In May 2008, UBS appointed a Skilled Person to undertake a review of its systems and controls. UBS has worked constructively with the Skilled Person and with the FSA to implement a remediation programme. Further, UBS has expended considerable resources following the Relevant Period to improve the defective systems and controls and to compensate those customers who were identified as having suffered financial loss as a result of the Unauthorised Trades.

UBS and its senior management have been open and co-operative with the Enforcement Investigation, which allowed for the timely and effective resolution of the investigation.

UBS also commissioned, at its own volition, a subsequent report by the same third party firm that conducted the Skilled Persons Report which concluded that (as at 30 June 2009), there have been *"very significant changes"* in the London Branch's international wealth management business and that *"the overarching control framework is adequate for the business as it is currently structured."*

(7) Disciplinary record and compliance history (DEPP 6.5.2(9))

On 17 November 2005, the FSA fined UBS £100,000 for failings in its transactional reporting. A copy of that Final Notice can be viewed here:

www.fsa.gov.uk/pubs/final/ubs_17nov05.pdf

The FSA has not taken into account these failings in determining the level of financial penalty, as it considers them to be unrelated to the conduct in issue.

(8) Other action taken by the FSA (DEPP 6.5.2(10))

In determining the level of financial penalty, the FSA has taken into account penalties imposed by the FSA on other authorised persons for similar behaviour. However, the FSA has also had regard to the principal purpose for which it imposes sanctions, namely, to promote high standards of regulatory conduct.

Conclusions

5.14 The FSA considers, in all the circumstances, that the seriousness of the breaches of Principles 2 and 3 by UBS merits a substantial financial penalty. In determining the proposed financial penalty, the FSA has considered the need to encourage firms to mitigate the risk of customers being disadvantaged by misconduct of employees. The FSA has also had regard to penalties in other similar cases.

5.15 The FSA considers, taking into account the applicable Stage 2 discount for early settlement, that a financial penalty of £8 million is appropriate.

6. DECISION MAKERS

6.1. The decision which gave rise to the obligation to give this Notice was made on behalf of the FSA by the Settlement Decision Makers.

7. IMPORTANT

7.1. This Final Notice is given to the UK operations of UBS in accordance with section 390 of the Act.

Manner of and time for Payment

7.2. The financial penalty must be paid in full by UBS to the FSA by no later than 19 August 2009, 14 days from the date of the Final Notice.

If the financial penalty is not paid

7.3. If all or any of the financial penalty is outstanding on 20 August 2009, the FSA may recover the outstanding amount as a debt owed by UBS and due to the FSA.

Publicity

7.4. Sections 391(4), 391(6) and 391(7) of the Act apply to the publication of information about the matter to which this notice relates. Under those provisions, the FSA must publish such information about the matter to which this notice relates as the FSA considers appropriate. The information may be published in such manner as the FSA considers appropriate. However, the FSA may not publish information if such publication would, in the opinion of the FSA, be unfair to UBS or prejudicial to the interests of consumers.

7.5. The FSA intends to publish such information about the matter to which this Final Notice relates as it considers appropriate.

FSA contacts

7.6. For more information concerning this matter generally, UBS should contact Mary O'Connor at the Enforcement Division of the FSA (direct line: 020 7066 1295/fax: 020 7066 1295).

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Jamie Symington
FSA Enforcement Division