

STATE OF WASHINGTON
DEPARTMENT OF FINANCIAL INSTITUTIONS
SECURITIES DIVISION

IN THE MATTER OF DETERMINING
whether there has been a violation
of the Securities Act of Washington by:

Order Number S-08-228-10-CO01

CONSENT ORDER

UBS SECURITIES LLC AND
UBS FINANCIAL SERVICES INC.,

Respondents.

WHEREAS, UBS Securities LLC and UBS Financial Services Inc. (collectively “UBS”) are broker-dealers registered in the state of Washington; and

WHEREAS, coordinated investigations into UBS’s activities in connection with certain of its sales of financial products known as auction rate securities (“ARS”) to retail and other customers have been conducted by a multistate task force (“task force”); and

WHEREAS, UBS has cooperated with regulators conducting the investigations by responding to inquiries, providing documentary evidence and other materials, and providing regulators with access to facts relating to the investigations; and

WHEREAS, UBS has advised regulators of its agreement to resolve the investigations relating to the sale and marketing of auction rate securities; and

WHEREAS, UBS agrees to implement certain changes with respect to its sales of ARS to retail and other customers, and to make certain payments; and

WHEREAS, UBS elects to permanently waive any right to a hearing and appeal under RCW 21.20.440 and RCW 34.05 with respect to this Administrative Consent Order (the “Order”).

CONSENT ORDER

1

DEPARTMENT OF FINANCIAL INSTITUTIONS
Securities Division
PO Box 9033
Olympia, WA 98507-9033
360-902-8760

1 NOW, THEREFORE, the Securities Administrator, as administrator of the Securities Act
2 of Washington, RCW 21.20, hereby enters this Order:

3 **I. JURISDICTION AND AUTHORITY**

4 1. UBS admits the jurisdiction of the Securities Division of the Washington State
5 Department of Financial Institutions, neither admits nor denies the Findings of Fact and
6 Conclusions of Law contained in this Order, and consents to the entry of this Order by the
7 Securities Division of the Washington State Department of Financial Institutions.

8 **II. RESPONDENTS**

9 2. UBS Securities LLC (“UBS Securities”) is a broker-dealer registered in the state
10 of Washington, with a Central Registration Depository (“CRD”) number of 7654.

11 3. UBS Financial Services Inc. (“UBS Financial Services”) is a broker-dealer
12 registered in the state of Washington, with a CRD number of 8174.

13 **III. FACTS AND ALLEGATIONS**

14 A. How UBS Marketed and Sold its ARS to its Clients

15 (1.) *UBS Wealth Management’s FAs Represented ARS to Clients as Safe, Liquid,*
16 *Cash Alternatives to Money-Market Instruments*

17 4. UBS customers in the State of Washington were sold ARS and, in most instances,
18 were told they were safe, liquid money-market instruments.

19 5. Many UBS customers were told that the interest rates on these instruments were
20 set periodically through the functioning of deep, liquid, fully functioning auctions that had never
21 failed for 20 years. Some were not told about the auction process at all, but simply thought they
22 were buying short-duration instruments.

1 6. Many UBS customers were not told that the majority of the auction rate products
2 available to them were limited to ARS that UBS underwrote.

3 7. Many UBS customers were not apprised of the risks of ARS, including the risk of
4 failed auctions or a market freeze.

5 8. Many UBS customers were not told that UBS had a policy of placing support bids
6 in every auction for which it was the sole or lead broker-dealer, that UBS routinely intervened in
7 the auction markets to set the interest rates, that certain potential conflicts of interest existed
8 between UBS and its customers, that in August 2007 UBS changed its policy of placing support
9 bids in every auction for which it was lead broker-dealer and allowed some of the ARS it had
10 underwritten to fail, or that after November 2007 UBS was actively considering scenarios that
11 included ceasing its practice of supporting its auctions.

12 9. After UBS decided to stop supporting its auctions, these clients were informed
13 that the market for these instruments had frozen and that they no longer held liquid short-term
14 instruments but instead held instruments with long or perpetual maturities for which no market
15 existed. Many of those instruments are no longer valued at par on UBS Financial Services
16 account statements.

17 (2.) *UBS Brokers who sold ARS to Clients Understood them to be Safe, Liquid Cash*
18 *Alternatives or Money-Market Instruments*

19 10. The UBS Financial Services Financial Advisors (“FAs”) that the task force
20 interviewed had not received any specific instruction or compliance training from UBS with
21 respect to ARS.

22 11. Many of the FAs that the task force interviewed did not have even the most basic
23 understanding of how ARS worked until after UBS pulled out of its auctions in February 2008.

1 (3.) *UBS Did Not Provide its Financial Advisors With Any Mandatory Training With*
2 *Respect to ARS*

3 12. UBS did not provide its FAs with mandatory training regarding ARS.

4 13. In testimony provided to the task force, the Director of Product Management for
5 UBS Financial Services (“Director of Product Management”) indicated a wide range of
6 information that FAs should know prior to selling ARS to customers, including the issuer’s
7 identity, the type of ARS, the credit quality, how the auction process works, and that a customer
8 bid may or may not get filled for that auction.

9 14. However, UBS did not provide mandatory training or specifically instruct its FAs
10 to apprise themselves of this information or provide customers with the information.

11 (4.) *UBS Marketed ARS to Clients as Safe, Liquid Instruments*

12 15. The UBS clients with whom the task force spoke uniformly stated that ARS had
13 been marketed to them as completely liquid, safe money-market type instruments.

14 16. UBS Financial Services posted on its public website a marketing piece “Cash &
15 Cash Alternatives Addressing Your Short-Term Needs,” which included Auction Preferred Stock
16 and Variable-Rate Demand Obligations as a cash alternative.

17 17. Similarly, in August 2007 UBS circulated its “Investment Intelligence” magazine,
18 which is “a quarterly ‘statement stuffer’ that is sent to all [UBS Financial Services] retail clients
19 and available to employees on the intranet.” The featured topic was “Planning Your Retirement
20 Cash Flow Strategy.” The feature included Auction Preferred Stock, Auction Rate Certificates,
21 and Variable-Rate Demand Obligations as cash alternatives. It also invited customers to request
22 a copy of *Putting Liquidity to Work: A Guide to Cash Alternatives*, which is a brochure UBS
23 made available to Financial Advisors to provide to clients starting in 2004, and which was posted
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1 on its external website in October 2007. This brochure identified a number of risks relating to
2 ARS, including the risk of auction failure, UBS's routine support of the auctions, the lack of any
3 obligation that UBS continue to support the market, and the conflicts of interest arising from
4 UBS's multiple roles in the auction market.

5 (5.) *ARS Were Listed Under the Heading "Cash Alternatives / Money Market*
6 *Instruments" on UBS Financial Services Client Statements Through January 2008*

7 18. Through January 2008, the client statements issued to retail customers listed APS
8 under the heading: "Cash Alternatives/Money Market Instruments."

9 19. In the February 2008 client statements, UBS removed the heading "Cash
10 Alternatives/Money Market Instruments" from its client statements. ARS were then referred to
11 as "Cash Alternatives/Other."

12 20. For the May 2008 and subsequent statements, the heading on UBS Financial
13 Services' account statements under which ARS appeared was changed again to "Fixed
14 Income/ARS."

15 21. Student loan auction rate certificates ("Student Loan ARCS") had been listed
16 under the heading "Cash Alternatives/Municipal Securities." This heading was changed to
17 "Fixed Income/ARS."

18 (6.) *UBS Did not Disclose Aspects of its ARS Program to its Clients*

19 22. UBS did not have any mandatory disclosures regarding ARS that its FAs were
20 required to make.

21 23. On this topic, the Director of Product Management testified that FAs were not
22 required by any specific policy to inform clients of the possibility that auctions may fail. He said
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1 that he did not believe that FAs were required to inform clients that UBS Securities routinely
2 intervened in the auction markets to prevent failure and to place a ceiling on clearing rates. He
3 also testified that UBS Financial Services' FAs were not informed that UBS Securities inventory
4 of ARS had exceeded the \$2.5 billion cap, though FAs would have been able to tell that UBS's
5 inventory was growing rapidly in January and February 2008 through the trading systems
6 available to them.

7 B. UBS's ARS Program Was Inconsistent With How It Was Promoted to Clients and
8 Financial Advisors

9 (1.) *Background on Mechanics of ARS*

10 a. Dutch Auction Process

11 24. A Dutch auction is a competitive bidding process used to determine rates of
12 interest on an instrument on each auction date. Bids are submitted to the auction agent by the
13 investors interested in buying or selling their securities. The auction agent matches purchase and
14 sale bids and the winning bid is the highest price (equivalent to the lowest rate) at which the
15 auction clears. At the auction a holder may submit one of the following orders:

- 16 – **Hold Order** – the holder wishes to continue to hold a position regardless of
17 rate.
- 18 – **Hold Rate Order or Bid Order** – the holder only wishes to continue to hold
19 a position or purchase a new position if the new rate is equal to or higher than
20 a specified rate.
- 21 – **Sell Order** – directs the broker-dealer to redeem the position at par regardless
22 of the new rate.

1 b. Types of Auction Rate Securities

2 (i.) *Auction Preferred Shares (“APS”)*

3 25. APS are equity instruments without a stated maturity issued by closed-end funds.
4 They are collateralized by the assets in that fund and typically receive ratings from the major
5 rating agencies. Interest rates are intended to be set in a Dutch auction process with auction
6 cycles typically of 7 or 28 days. Typically, they have a maximum rate above which the interest
7 rate cannot be set in an auction.

8 (ii.) *Municipal Auction Rate Certificates*

9 26. Municipal auction rate certificates (“Municipal ARCS”) are debt instruments
10 (typically municipal bonds) issued by governmental entities with a long-term nominal maturity
11 and a floating interest rate that is intended to be reset through a Dutch auction process. They
12 receive long-term ratings from the major rating agencies and are often backed by monoline
13 insurance.

14 (iii.) *Student Loan-Backed Auction Rate Certificates*

15 27. Student Loan-backed auction rate certificates (“Student Loan ARCS”) are long-
16 term debt instruments issued by trusts that hold student loans. Interest rates are intended to be
17 set in a Dutch auction process, and typically Student Loan ARCS have a maximum rate above
18 which the interest rate cannot be set in an auction. They receive long-term ratings from the
19 major rating agencies.

20 28. References to ARS herein shall include three separate categories of instruments:
21 APS of closed-end funds, Municipal ARCS, and Student Loan ARCS.

1 (2.) *UBS's ARS Program*

2 a. Underwriting

3 29. UBS Securities was one of the largest underwriters of Municipal ARCS and
4 Student Loan ARCS.

5 30. UBS Securities was a large underwriter of APS until it ceased underwriting those
6 shares in 2005 or 2006.

7 31. UBS's compensation for underwriting ARS was typically one percent of the
8 amount underwritten.

9 32. UBS competed with other investment banks to provide low-cost financing to ARS
10 issuers. Its ability to do so was a key factor in its ability to generate additional ARS
11 underwriting business.

12 b. Broker-Dealer Agreements

13 33. For the ARS that it underwrote, UBS Securities typically served as a manager of
14 those auctions.

15 34. UBS Securities often served as lead manager, but sometimes served as co-
16 manager of auctions with other large broker-dealers.

17 35. UBS Securities' management responsibilities were typically set forth in an
18 agreement called a broker-dealer agreement that it entered into with the issuer.

19 36. UBS Securities' compensation under those broker-dealer agreements was
20 typically 20-25 basis points annualized of the amount managed.

1 37. UBS Securities shared a portion of its management fee with UBS Financial
2 Services and its Financial Advisors in connection with the sale of ARS to customers of UBS
3 Financial Services.

4 c. Distribution of ARS by UBS Financial Services

5 38. UBS Financial Services served as the primary distribution source for the ARS that
6 UBS Securities underwrote.

7 39. Most of the ARS sold to clients of UBS Financial Services came from UBS
8 Securities' ARS program.

9 40. UBS Financial Services did not do its own due diligence to discern whether
10 particular ARS were quality instruments to be offered to its retail clients.

11 41. The Director of Product Management testified that since joining UBS Financial
12 Services in 2005, he could not recall any instance in which UBS Financial Services had rejected
13 or declined to distribute to its customers an ARS product underwritten by UBS Securities.

14 42. FAs received a portion of 25 basis points annualized of the total amount of ARS
15 held by their clients.

16 43. FAs received no commission for their clients' investments in UBS's standard
17 money-market fund.

18 d. UBS Routinely Placed Support Bids in Order to Prevent Failed Auctions

19 44. On all of the auctions for which it was the sole or lead broker-dealer, UBS
20 Securities placed support bids to ensure that the auctions would not fail.

21 45. According to information provided by UBS to the task force, in auctions for APS
22 from January 1, 2006 through February 28, 2008, UBS Securities submitted support bids in
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1 27,069 auctions. The support bids were drawn upon in order to prevent a failed auction 13,782
2 times, which represented 50.9 percent of those auctions.

3 46. According to information provided by UBS to the task force, in auctions for
4 Municipal ARCS and Student Loan ARCS from January 1, 2006 through February 28, 2008,
5 UBS Securities submitted support bids in 30,367 auctions. The support bids were drawn upon in
6 order to prevent a failed auction 26,023 times, which represented 85.7 percent of those auctions.

7 47. If UBS had not placed support bids in auctions, UBS's auction rate program
8 would have failed.

9 e. UBS's Setting of Interest Rates

10 (i.) *Price Talk*

11 48. Prior to every auction for which it was the sole or the lead broker-dealer, UBS
12 engaged in price talk. Price talk consisted of a range of bids that UBS Securities transmitted to
13 UBS Financial Services' FAs indicating where UBS Securities expected the auctions to clear.

14 (ii.) *Setting Interest Rates by Placing Bids*

15 49. UBS influenced ARS interest rates by submitting buy and sell bids from its own
16 inventory.

17 50. UBS's Short Term Desk frequently set the rate at which the auction would clear.

18 51. In the Fall of 2007, UBS raised the interest rates it set on ARS in part in response
19 to a buildup of inventory of ARS.

20 52. In contrast to the understanding that retail investors were given that the interests
21 rates on these securities were actually set through the auction process, the Head of Short-Term
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1 Trading said, "We are making pricing decisions based on our ability to attract investors while
2 managing issuer client relationships and will continue to do so in efforts to move securities."

3 (3.) *In August 2007 UBS Intentionally Allowed Certain of its Auctions to Fail*

4 53. In August 2007, a number of broker-dealers, including UBS, failed some of their
5 auctions for certain auction products that were issued in private placements relating to the CDO
6 market and certain auction products issued by monoline insurance companies.

7 54. In August 2007, UBS intentionally allowed to fail the auctions for sixteen (16)
8 CUSIPS.

9 55. These same auctions continued to fail in the Fall of 2007.

10 (4.) *UBS's Inventory of ARS Increased Substantially from August 2007 through mid-*
11 *February 2008*

12 a. Inventory Increased Beyond Cap Imposed by Risk Management

13 56. UBS's inventory of ARS, which it added to each time it supported an auction that
14 otherwise would have failed, began to increase after the auction failures in August 2007.

15 57. UBS's risk-control division imposed limits on the amount of auction rate
16 inventory UBS could hold.

17 58. When the inventory obtained by supporting auctions was reached, the Short-Term
18 Desk had to request from risk-management an increase in that cap.

19 59. UBS's support of the auctions caused its inventory of ARS to increase even more
20 in 2008.

1 b. Pushback from Risk Management

2 60. In the fall of 2007 and the beginning of 2008, UBS's risk management group was
3 beginning to express concerns about the increase in the buildup of ARS. Risk management
4 expressed these concerns in the context of the short-term desk's repeated requests to take on
5 inventory of ARS above the caps imposed by risk management.

6 61. For example, an e-mail dated August 15, 2007, from an employee in the
7 investment bank's risk function (who worked with the investment bank's Chief Risk Officer in
8 the Americas), stated: "Limited extension [of permission to operate over peak auction rate
9 security inventory limit] granted for one night. There is little tolerance for increased inventory
10 firm wide; please continue to price aggressively to keep inventory down."

11 (5.) *UBS Attempted to Limit the Buildup of Auction Rate Securities Inventory*

12 a. Enhanced Marketing Efforts for ARS

13 62. As UBS's inventory of ARS began to grow, the Global Head of UBS's Municipal
14 Securities Group led an effort to sell more of that inventory.

15 63. This effort began in August 2007 and continued until UBS pulled out of the
16 market in February 2008.

17 64. A concerted marketing effort was made to get the FAs to sell ARS.

18 65. In early 2008, in response to a substantial decrease in corporate cash demand for
19 ARS, UBS began an education campaign to ensure that FAs understood the true credit quality of
20 the ARS.

1 b. Waivers of Maximum Rates on Student Loan-Backed Auction Rate
2 Certificates

3 66. The maximum rate at which Student Loan ARCS could reset was too low to
4 compensate investors for the perceived risk of those instruments during the period between
5 August 2007 and February 2008. Many APS suffered from a similar flaw.

6 67. These maximum rates were well known to UBS as UBS Securities had built them
7 into the instruments in order to make them more palatable to their underwriting clients.

8 68. The maximum rates often allowed the issuers to obtain a higher rating on the
9 product in part because capping the interest rate on the product allowed them to satisfy the cash
10 flow stress-tests of the rating agencies.

11 69. As investors shied away from ARS after August 2007, UBS's inventory began to
12 grow dramatically and it needed to keep raising interest rates in order to move the paper.

13 70. However, as those interest rates began to approach the maximum rates on the
14 securities with restrictive maximum rates, UBS began an effort to get its issuer clients to agree to
15 a temporary increase in maximum rates and to seek waivers from the rating agencies in order to
16 allow the interest rates on those instruments to rise to a level where those instruments could clear
17 the market, until the market recovered or UBS could work with issuers to restructure.

18 71. Those waivers were short-term in nature and many that had been obtained in 2007
19 were set to expire in early 2008.

20 72. UBS became very concerned that when these waivers expired, these instruments
21 would hit the maximum rate and the rate would reset to a level that would not be appealing to
22 investors, thus requiring UBS to take on even more Student Loan ARCS.

1 73. In January 2008, UBS continued to seek waivers of the maximum rates from
2 issuers.

3 74. UBS did not disclose its concerns with respect to maximum rates of Student Loan
4 ARCS to investors.

5 75. Moreover, UBS's FAs were not aware of issues related to the maximum rate and
6 did not explain them to customers.

7 (6.) *After August 2007, UBS's Concerns Regarding ARS Intensified Causing UBS To*
8 *Debate Its Ongoing Role In The Auction Markets*

9 76. After August 2007, there was an ongoing dialogue within UBS as to the condition
10 of the auction markets, with particular emphasis on Student Loan ARCS.

11 77. In the Summer and Fall of 2007, UBS began a balance sheet reduction program,
12 which required all divisions, including the short-term desk, to contribute to liquidity creation and
13 balance sheet reduction.

14 78. By early December 2007, it became clear that many institutional buyers were no
15 longer interested in ARS.

16 79. On December 12, 2007, the Head of Flow, Sales and Trading sent an e-mail to the
17 Global Head of Municipal Securities in which he stated: "The auction product does not work and
18 we need to use our leverage to force the issuers to confront this problem our options are to resign
19 as remarketing agent or fail or?"

20 80. Of note, that same day, the Global Head of Municipal Securities sold his
21 remaining personal shares of ARS while continuing to engage in enhanced marketing efforts to
22 clients. He subsequently explained that he made these sales because "my risk tolerance from a
23 credit perspective was — was something that drove me to want to sell" ARS.

1 81. A student loan task force was set up at UBS in mid-December 2007.

2 82. In addition to the student loan task force, in December 2007, a working group
3 was convened to discuss the broader condition of UBS's ARS program. According to UBS's
4 response to interrogatories propounded by the task force, "In late 2007, UBS formed a working
5 group that addressed the general market conditions for ARS, as well as UBS' continued role in
6 ARS auctions."

7 83. The working group held meetings on December 21, 2007, January 4, 2008,
8 January 18, 2009, February 1, 2008 and February 29, 2008.

9 84. The working group discussed, among other things, the buildup in UBS's
10 inventory of ARS and strategies for exiting the auction markets.

11 *(7.) UBS's Conflicted Role in Serving Underwriting Clients Versus Acting in the Best*
12 *Interests of Retail Wealth Management Clients*

13 85. UBS's auction rate program, in which it actively managed to influence the interest
14 rates on ARS (which interest rates, in theory, should have been set by auctions), put it in a
15 fundamentally conflicted role.

16 86. On one hand, as set forth in detail above, UBS often needed to raise interest rates
17 in order for auction paper to clear. On the other hand, if UBS raised interest rates too high, it ran
18 afoul of its underwriter clients, to whom it had promised low-cost financing.

19 87. Many UBS Financial Services' investors were unaware of this conflict, as it was
20 never disclosed to them.

21 88. Many retail purchasers of UBS auction rate paper thought that the interest rates
22 were set by the auction markets, not by UBS's setting of the interest rates resulting from its
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1 balancing of the needs of its underwriting clients and its need to move the product so that its
2 inventory did not grow too large.

3 89. This conflict became more acute when the auction markets began to crumble. If
4 UBS did not raise rates enough, there would not be sufficient buying interest and UBS would
5 have to take more auction rate paper onto its books. If UBS raised rates too high, the auction
6 results could significantly increase the cost of financing to UBS's issuer clients.

7 (8.) *UBS Financial Advisors Were Not Apprised of this Back Story*

8 90. As the auction rate market began to show some stress in August 2007, which
9 gained intensity through the end of 2007 and January 2008, many customers were not informed
10 of problems in the ARS market.

11 91. Up through at least February 8, 2008, and in connection with updates to FAs of
12 events occurring in the auction rate market, FAs were informed as follows:

13 The public auction market continues to clear hundreds of auctions daily, with
14 lead-broker-dealers frequently bidding to clear auctions where needed. While
15 broker-dealers are not obligated to bid in auctions, we do not have reason to
16 change our current practice when UBS is lead underwriter. We will continue to
17 monitor developments so that we responsibly serve our clients and shareholders.

18 92. This message came one day after the Global Head of Municipal Securities, in a
19 February 7, 2008 e-mail to certain UBS personnel on the topic of whether UBS was
20 contemplating failing auctions, stated, regarding the auction rate market: "clock ticking-not
21 sustainable."

22 93. In stark contrast to the sales of personal holdings of ARS by the Global Head of
23 Municipal Securities in August and December 2007, customers who were kept in the dark about
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1 UBS's concern about the viability of the program and UBS's wavering commitment to the
2 program, found themselves stuck.

3 (9.) *UBS Failed Its Auctions On February 13, 2008*

4 94. UBS Financial Services' FAs kept selling ARS through February 12, 2008.

5 95. On February 13, without prior notice to its customers who had purchased ARS,
6 UBS failed its auctions for ARS.

7 **IV. CONCLUSIONS OF LAW**

8 1. The Securities Division of the Washington State Department of Financial
9 Institutions has jurisdiction over this matter pursuant to the Securities Act of Washington, RCW
10 21.20.

11 2. UBS Failed to Supervise. As described in the Findings of Fact above, UBS failed
12 to reasonably supervise its agents with respect to the marketing and sale of ARS. As a result,
13 UBS violated RCW 21.20.110(1)(j).

14 3. UBS Engaged in Dishonest and Unethical Practices. As described in the Findings
15 of Fact above, UBS engaged in dishonest and unethical practices with respect to the marketing
16 and sale of ARS. As a result, UBS violated RCW 21.20.110(1)(g).

17 4. The Securities Division of the Washington State Department of Financial
18 Institutions finds the following relief appropriate and in the public interest.

19 **V. ORDER**

20 On the basis of the Findings of Fact, Conclusions of Law, and UBS's consent to the entry
21 of this Order without admitting or denying the facts or conclusions herein,

22 **IT IS HEREBY ORDERED:**

1 1. This Order concludes the investigation by the Securities Division of the
2 Washington State Department of Financial Institutions and, except as provided in Paragraph V.19,
3 precludes any other action that the Securities Division of the Washington State Department of
4 Financial Institutions could commence under applicable Washington State law on behalf of the
5 State of Washington as it relates to UBS's marketing and sale of ARS.

6 2. This Order is entered into solely for the purpose of resolving the above-referenced
7 multistate investigation, and is not intended to be used for any other purpose.

8 3. UBS shall cease and desist from violating the Securities Act of Washington and will
9 comply with the Securities Act of Washington.

10 4. Within ten (10) days after the entry of this Order, UBS shall pay the sum of
11 \$1,805,294.31 to the State of Washington as a civil monetary penalty pursuant to RCW
12 21.20.110 and RCW 21.20.395, to be deposited in the Securities Prosecution Fund, RCW
13 43.320.115, which amount constitutes the State of Washington's proportionate share of the total
14 state settlement amount of \$75 million dollars (\$75,000,000).

15 5. UBS shall take certain measures with respect to certain current and former
16 customers as related to "Eligible ARS," as defined in Paragraph V.6.

17 6. Eligible ARS. For purposes of this Order, "Eligible ARS" means ARS that failed
18 at least once in auctions between August 8, 2008 and October 7, 2008.

19 7. Eligible Customers. As used in this Order, an "Eligible Customer" is any current
20 or former UBS customer (not including (i) broker-dealers or (ii) banks acting as conduits for
21 their customers) who opts in to the relief provided pursuant to this Order and meets any of the
22 following criteria:
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- 1 a. Held the Eligible ARS at UBS as of February 13, 2008 or in DVP accounts as
2 of February 13, 2008 for which UBS had bidding rights; or
3 b. Purchased Eligible ARS at UBS between October 1, 2007 and February 12,
4 2008, and transferred those ARS out of UBS prior to February 13, 2008;

5 8. Offer periods.

6 a. First Offer Period.

- 7 i. No later than October 31, 2008, UBS shall have offered to purchase at
8 par Eligible ARS from all Eligible Customers who:

9 (a) Meet the criteria under Paragraphs V.7.a or V.7.b;

10 (b) Are either:

11 i. Individual customers, or

12 ii. Charities, endowments, or foundations with Internal Revenue
13 Code Section 501(c)(3) status; and

14 (c) Have less than \$1 million in assets at UBS as determined by the
15 investor's aggregate household asset position at UBS on August 8,
16 2008.

17 (d) In cases in which investor classification under this subsection is
18 ambiguous, such classification will be determined by UBS in the
19 exercise of its reasonable good faith judgment.

- 20 ii. This First Offer Period will remain open until January 4, 2011.

21 b. Second Offer Period.

- 22 i. No later than January 2, 2009, UBS shall have offered to purchase at
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1 par Eligible ARS from all Eligible Customers who meet the criteria
2 under Paragraphs V.7.a or V.7.b and are:

3 (a) Individual customers,

4 (b) Charities, endowments or foundations with Internal Revenue Code
5 Section 501(c)(3) status, or

6 (c) Small businesses (entities with less than \$10 million in assets with
7 UBS as of August 8, 2008).

8 ii. Notwithstanding any other provision, institutional customers who have
9 represented they have total assets of greater than \$50 million, or
10 otherwise are determined to have assets greater than \$50 million, as of
11 August 8, 2008, are covered by the Third Offer Period (described in
12 Paragraph V.8.c) and not by the Second Offer Period.

13 iii. In cases in which investor classification under this subsection is
14 ambiguous, such classification will be determined by UBS in the
15 exercise of its reasonable good faith judgment.

16 iv. This Second Offer Period will remain open until January 4, 2011.

17 c. Third Offer Period – Institutional Customers. No later than June 30, 2010,
18 UBS shall offer to purchase at par Eligible ARS from all remaining Eligible
19 Customers who meet the criteria under Paragraphs V.7.a and V.7.b.

20 d. This Third Offer Period will remain open until July 2, 2012.

21 9. Customer Notification and Opt In Procedures.

22 a. Initial Notice. UBS shall have sent notice (“ARS Settlement Notice”) to each
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1 Eligible Customer. The ARS Settlement Notice shall have described the
2 relevant terms of this Order as related to Eligible Customers and shall have
3 informed the customers that they could opt in to the relief described in the
4 ARS Settlement Notice within thirty (30) days after the mailing date of the
5 ARS Settlement Notice (“Initial Opt In Period”).

6 b. Second Notice and Opt In. To the extent that any Eligible Customer did not
7 opt in during the Initial Opt In Period, UBS shall have provided any such
8 customer a second written notice describing the relevant terms of this Order as
9 related to Eligible Customers within seven (7) business days of the expiration
10 of the Initial Opt In Period. Customers will have had thirty (30) days after the
11 mailing date of the second written notice to notify UBS that they opt in to the
12 relief described in the ARS Settlement Notice. This Order does not require
13 UBS to purchase the ARS of any customer that was mailed the ARS
14 Settlement Notice but did not opt in to the relief described in the ARS
15 Settlement Notice. Any customer who did not opt in to the relief provided
16 pursuant to this Order may pursue any other remedies against UBS available
17 under the law.

18 c. Customer Assistance Line and Internet Page. Within five (5) business days of
19 the entry of this Order, UBS shall have updated: (i) its dedicated toll-free
20 telephone ARS assistance line, with appropriate staffing, to provide
21 information and to respond to questions concerning the terms of this Order;
22 and (ii) the public Internet page regarding ARS on UBS’s corporate Web
23

1 site(s), with a prominent link to that page appearing on UBS's relevant
2 homepage(s), to provide information concerning the terms of this Order and,
3 via an e-mail address or other reasonable means, to respond to questions
4 concerning the terms of this Order. UBS shall maintain the telephone
5 assistance line and Internet page through June 30, 2010 or the completion of
6 UBS's obligation pursuant to Paragraph V.15 of this Order, whichever is later.

7 10. Purchase Procedures.

8 a. Customers Eligible Under Paragraph V.8. For customers eligible for an offer
9 under Paragraph V.8 who opted in to the relief described in the ARS

10 Settlement Notice:

11 i. UBS Offer. UBS shall have offered to purchase their Eligible ARS at
12 par plus any accrued and unpaid dividends/interest during the relevant
13 timeframe specified in Paragraph V.8. These customers may enter a
14 sell order to sell their Eligible ARS at par to UBS at any time during
15 the relevant timeframe.

16 ii. Discretionary Sales on Behalf of Customers. Starting on the business
17 day following the date that an Eligible Customer opted in to the relief
18 described in the ARS Settlement Notice, UBS shall be authorized to
19 exercise discretion on such customer's behalf to effect sales or other
20 dispositions of Eligible ARS, including but not limited to secondary
21 sales. UBS shall make customers whole at par (plus any accrued and
22 unpaid dividend/interest) if any such disposition occurs below par.

1 Any such discretion shall be exercised by UBS solely for the purpose
2 of facilitating restructurings, dispositions, or other par solutions for
3 customers. UBS represents that the purpose of this aforementioned
4 discretion is to permit UBS to mitigate potential damages while still
5 returning par to customers. In addition, starting the business day
6 following the date on which an Eligible Customer opted in to the relief
7 described in the ARS Settlement Notice, UBS shall be authorized to
8 exercise reasonable discretion to purchase at par Eligible ARS that are
9 tax-exempt Auction Preferred Stock issued by closed-end funds.

10 iii. Written Notice of Expiration. Thirty (30) days before the expiration of
11 each relevant timeframe set forth in Paragraph V.8, UBS shall provide
12 written notice to those customers eligible under Paragraph V.8 who
13 have not sold their Eligible ARS to UBS. This written notice shall
14 notify the customers about the impending expiration of the relevant
15 timeframe, describe the state of the ARS market at that time, and
16 explain the consequences of failing to sell their ARS to UBS prior to
17 the expiration of the relevant timeframe.

18 b. Returning ARS to UBS Custody. Because the Eligible ARS must be in UBS
19 custody prior to UBS being able to purchase such ARS, the customer must
20 return the Eligible ARS to UBS's custody before placing an order to sell the
21 Eligible ARS to UBS. To this end, UBS shall use its best efforts to assist
22 customers eligible for relief under this Order who have transferred ARS out of
23

1 UBS custody in returning Eligible ARS to UBS custody and shall not charge
2 such customers any fees relating to or in connection with the return to UBS or
3 custodianship by UBS of such Eligible ARS.

4 11. Customer Priority. UBS agrees that it will not take advantage of liquidity
5 solutions for its own inventory without making them available, as soon as practicable, to its
6 customers that opted in to the relief provided pursuant to this Order who hold the same CUSIP(s)
7 of ARS in their accounts. This obligation shall continue until June 30, 2010.

8 12. Relief for Customers Who Sold Below Par. UBS shall make best efforts to
9 identify any such Eligible Customers who sold Eligible ARS below par between February 13,
10 2008 and September 15, 2008. By October 31, 2008, UBS shall have paid any Eligible
11 Customer so identified the difference between par and the price at which the customer sold the
12 Eligible ARS, plus reasonable interest thereon. UBS shall promptly pay any such Eligible
13 Customer identified after October 31, 2008.

14 13. Refund of Refinancing Fees to Municipal Issuers. By June 30, 2009, UBS shall
15 have refunded to municipal issuers underwriting fees each issuer paid to UBS for the refinancing
16 or conversion of ARS that occurred after February 13, 2008, where UBS acted as underwriter for
17 both the primary offering of ARS between August 1, 2007 and February 12, 2008, and the
18 refunding or conversion of the ARS after February 13, 2008.

19 14. Negative Carry on Prior ARS Loan Programs. With respect to each customer
20 who took out a loan from UBS (directly or indirectly) using the firm's prior ARS loan programs
21 since February 13, 2008, UBS shall promptly reimburse the customer for any excess interest
22 costs associated with such loan when compared to the interest paid on average on the Eligible
23

1 ARS that are the subject of the loan, plus reasonable interest thereon.

2 15. Purchase from Certain Additional Customers.

- 3 a. Subject to the limitations described in Paragraphs V.15.d. and V.15.e, with
4 respect to former UBS customers who are either individuals; charities,
5 endowments, or foundations with Internal Revenue Code Section 501(c)(3)
6 status; or small businesses (entities with less than \$10 million in assets with
7 UBS other than institutional customers who have represented they have total
8 assets of greater than \$50 million, or otherwise are determined to have assets
9 greater than \$50 million, as of August 8, 2008), and who purchased Eligible
10 ARS at UBS on or after January 1, 2000 and transferred the Eligible ARS
11 from UBS before February 13, 2008 and continue to own the Eligible ARS,
12 UBS shall offer to purchase the customer's Eligible ARS at par plus any
13 accrued and unpaid dividends/interest, provided such customer has contacted
14 or contacts UBS to request that UBS purchase the Eligible ARS.
- 15 b. Within thirty (30) days of March 4, 2010, UBS shall offer to purchase Eligible
16 ARS from each customer eligible under Paragraph V.15.a who is recorded as
17 having contacted UBS before March 4, 2010.
- 18 c. For each customer eligible under Paragraph V.15.a who contacts UBS after
19 March 4, 2010, within thirty (30) days of UBS receipt of the customer's
20 request, UBS shall offer to purchase Eligible ARS from such customer.
- 21 d. The Eligible ARS must be in UBS custody prior to UBS being able to
22 purchase such ARS under this section. Former customers who are eligible
23
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1 under this section must return the Eligible ARS to their prior UBS account or,
2 in the case of former accounts that have been purged, to new UBS accounts
3 opened by the customer. UBS shall not charge such customers any fees
4 relating to or in connection with the return to UBS of such Eligible ARS.

5 e. UBS's obligations under Paragraph V.15.a will expire after UBS has
6 purchased Eligible ARS pursuant to Paragraph V.15.a with a total value of
7 \$200 million ("The Purchase Obligation"). The Purchase Obligation includes
8 sums paid to any customer eligible under these provisions as well as any
9 similar provisions with any other state. Customers covered by Paragraph
10 V.15.c. will be prioritized based on date of receipt of claim. The Purchase
11 Obligation also will include any amounts UBS paid to customers covered by
12 Paragraph V.15.a prior to the execution of the Consent Order. Furthermore,
13 UBS's obligation under Paragraph V.15.a will be stayed during any period
14 that the sum paid and/or offered to be paid pursuant to Paragraph V.15.a
15 equals or exceeds \$200 million.

16 f. UBS has indicated that it will require each customer accepting a purchase
17 offer under this Paragraph V.15 to provide UBS with a full release of claims
18 as a condition to UBS's agreement to repurchase. Such requirement will not
19 be construed as a violation of this Order, or as otherwise prohibited by this
20 Order.

21 16. Best Efforts. Notwithstanding UBS's obligations pursuant to Paragraph V.8.c,
22 UBS shall have used its best efforts to, by December 31, 2009, provide liquidity solutions at par
23

1 for UBS institutional customers (not including (i) broker-dealers or (ii) banks acting as conduits
2 for their customers) by, among other things, facilitating issuer redemptions, and/or
3 restructurings.

4 17. Reports and Meetings.

- 5 a. Reports. Within thirty (30) days after March 4, 2010, and then quarterly after
6 that, UBS shall submit a written report detailing UBS's progress with respect
7 to its obligations under paragraph V.15. This report shall be submitted to a
8 representative specified by the North American Securities Administrators
9 Association ("NASAA").
- 10 b. The reporting obligation set forth above may be amended with written
11 permission from a designated NASAA representative.

12 18. Special Arbitration Process.

- 13 a. UBS shall consent to participate, at the customer's election, in the special
14 arbitration procedures described below. Under these procedures, an
15 arbitration process, under the auspices of the Financial Industry Regulatory
16 Authority ("FINRA"), will be available for the exclusive purpose of
17 arbitrating consequential damages claims by individual (non-institutional)
18 Eligible Customers who meet the criteria under paragraphs V.8.a and V.8.b.
19 above.
- 20 b. Applicable procedures.
- 21 i. Arbitrator. The special arbitrations will be conducted by a single
22 public arbitrator.

1 any such disqualifications.

2 3. For any person or entity not a party to this Order, this Order does not limit or create
3 any private rights or remedies against UBS including, without limitation, the use of any e-mails or
4 other documents of UBS or of others for the marketing and sale of ARS to investors, limit or create
5 liability of UBS, or limit or create defenses of UBS to any claims. Further, nothing in this Order
6 shall affect UBS's ability to defend itself against claims in litigation.

7 4. This Order shall not disqualify UBS or any of its affiliates or current or former
8 employees from any business that they otherwise are qualified or licensed to perform under
9 applicable securities laws of the State of Washington. In addition, this Order is not intended to
10 form the basis for any such disqualifications.

11 5. This Order and any dispute related thereto shall be construed and enforced in
12 accordance with, and governed by, the laws of the State of Washington without regard to any
13 choice of law principles.

14 6. UBS, through its execution of this Consent Order, voluntarily waives its right to a
15 hearing on this matter and to judicial review of this Consent Order under RCW 21.20.440 and
16 RCW 34.05.

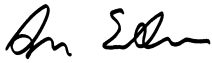
17 7. UBS enters into this Consent Order voluntarily and represents that no threats,
18 offers, promises, or inducements of any kind have been made by the Securities Division of the
19 Washington State Department of Financial Institutions or any member, officer, employee, agent,
20 or representative of the Securities Division of the Washington State Department of Financial
21 Institutions to induce UBS to enter into this Consent Order.

22 8. This Order shall be binding upon UBS and its successors and assigns as well as to
23
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1 successors and assigns of relevant affiliates with respect to all conduct subject to the provisions
2 above and all future obligations, responsibilities, undertakings, commitments, limitations,
3 restrictions, events, and conditions.

4
5
6 Dated and Entered this 27th day of May, 2010.

7 By:

8 

9 _____
10 Suzanne Sarason
11 Chief of Enforcement

12 Presented by:

13 

14 _____
15 Bridgett Fisher
16 Enforcement Attorney

1 Dated this 14 day of May, 2010.

2
3 UBS Securities LLC

4
5 /s/
6 By: Alan Brudner
7 Title: Head of Litigation & Investigations, Americas
8 UBS Securities LLC

9 State of New York)
10) ss.
11 County of Queen)

12 SUBSCRIBED AND SWORN TO before me this 14 day of May 2010.

13
14 /s/ Dona Valva
15 Notary Public

16 My commission expires:
17
18 1-11-14

