UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9438 / August 6, 2013

SECURITIES EXCHANGE ACT OF 1934
Release No. 70121 / August 6, 2013

INVESTMENT ADVISERS ACT OF 1940
Release No. 3643 / August 6, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-15407

In the Matter of **UBS SECURITIES LLC,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO 8A OF THE SECURITIES ACT OF 1933, SECTION 15(b)(4) OF THE SECURITIES EXCHANGE ACT OF 1934, AND SECTIONS 203(E) AND 203(K) OF THE INVESTMENT ADVISERS ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act"), Section 15(b)(4) of the Securities Exchange Act of 1934 ("Exchange Act"), and Sections 203(e) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act") against UBS Securities LLC ("Respondent" or "UBS").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933, Section 15(b)(4) of the Exchange Act, and Sections 203(e) and 203(k) of the Investment

Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds[1] that:

Summary

1. UBS violated certain provisions of the federal securities laws in connection with the structuring and marketing of a largely synthetic collateralized debt obligation ("CDO") known as ACA ABS 2007-2 ("ACA 07-2"). UBS structured this CDO, and marketed it together with the CDO's collateral manager, ACA Management LLC ("ACA"). The CDO's collateral consisted largely of credit default swaps ("CDS") referencing subprime residential mortgage-backed securities ("RMBS").

2. As collateral manager, ACA was responsible for determining the price that the CDO paid for collateral. In the case of CDS collateral, the price was the amount the CDO was paid for selling protection on the underlying asset. ACA typically would select collateral for this type of CDO by sending out to the street BWIC ("bids wanted in competition") lists soliciting bids for CDS on particular single-name RMBS. The winners of the BWIC process would be those counterparties who offered to pay the highest premiums on the CDS. For example, a counterparty might agree to pay a running spread of 550 basis points to purchase protection against default on $10 million of a designated reference obligation. The counterparty would pay this running spread to the investment bank that was structuring the CDO for a certain number of years, with the bank agreeing to pay the $10 million notional amount to the counterparty in the event that the reference security defaulted. The bank, in its role as CDS counterparty to the CDO, would then pay the same running spread minus a small intermediation fee to the CDO, with the CDO agreeing to pay the $10 million notional amount to the bank in the event that the reference security defaulted. (The spreads are called "running" because the counterparty agrees to make the payments on a regular basis until maturity or default. In the example above, the annual dollar value of the running spread would be $550,000.)

3. For ACA 07-2, however, the bidding on a number of BWICs was bifurcated: UBS and ACA agreed that, in certain BWICs, ACA would instruct prospective bidders to bid in two parts. The first part was a specified running spread: for example, in the first BWIC, ACA told prospective bidders that they would need to pay a running spread of 300 basis points. The spread was nonnegotiable. Instead, the competition was over the second part, called "upfront points." ACA solicited the upfront points as one-time cash payments to be made by the bidders to UBS when the CDS were traded. Thus, the winners of the BWIC were those who, in addition to agreeing to pay the specified base premium, bid the highest number of upfront points.

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[1] The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

4. By the time the ACA 07-2 CDO was launched, the BWICs had resulted in approximately $23.6 million in upfront points. However, those upfront points were retained by UBS and not contributed to the CDO. The marketing materials for the CDO did not disclose UBS's retention of the $23.6 million in upfront points. The materials further represented that the CDO had to acquire all collateral "on an 'arm's-length basis' for fair market value," or at the price the collateral was acquired by UBS. This representation was inaccurate because the CDO did not receive the $23.6 million in upfront points retained by UBS. UBS employees referred to the upfront points internally as an extra "fee" on top of UBS's disclosed fee of approximately $10.8 million. Additionally, UBS negligently caused violations of the securities laws by ACA, which had a fiduciary duty as an investment adviser to ACA 07-2.

Respondent

5. **UBS Securities LLC ("UBS")** is a Delaware entity with principal executive offices in Stamford, CT and New York, NY. It is a broker-dealer and investment adviser dually registered with the SEC through which UBS AG principally conducts its investment banking business in the U.S.

Other Relevant Entity

6. **ACA Management LLC ("ACA")**, a Delaware entity headquartered in New York, NY, was the entity through which ACA Financial Guaranty Corporation ("ACAFGC") operated its CDO advisory business. ACA was registered with the SEC as an investment adviser in 2006 and 2007. ACA's CDO management business was sold to third parties in 2008 as part of the restructuring of ACAFGC. ACA no longer has any advisory business or responsibilities, and the sole function of ACAFGC is to operate as a runoff municipal bond insurance company under the oversight of the Maryland Insurance Administration.

Background

7. A CDO is a special-purpose vehicle that raises capital principally through the issuance of debt securities and uses the proceeds to invest in fixed-income securities, often real estate assets. The CDO's debt is issued in different tranches that feature varying risks and rewards. The highest-rated tranche has the first priority of repayment through what is called the CDO's waterfall. In other words, on certain predetermined payment dates, the holders of the higher tranches of debt are the first to receive their scheduled principal and/or interest payments. Because of their priority of repayment, the higher tranches have lower rates of return. In contrast, holders of lower-rated tranches generally are paid only after more senior holders are paid and these tranches feature higher rates of return. At the bottom of the waterfall sits the equity holder, which receives any residual payments available after the debt holders receive their scheduled payments.

8. A CDS is a type of derivative through which two parties transfer the risk of ownership of a particular reference obligation. The protection buyer of a CDS pays to purchase protection from a default, downgrade, or another credit event impacting the reference obligation. The protection seller sells that protection and assumes the risk of a credit event on the reference obligation. In this way the protection seller of the CDS operates as a kind of insurer to the buyer,

for which the seller receives some form of payment. A reference obligation can take many forms. In ACA 07-2, the reference obligations were securitized pools of residential mortgage loans. In addition, the form of payment that the protection buyer pays to the protection seller can take different forms. Several of the CDS acquired for the ACA 07-2 warehouse featured not only the typical periodic "running spreads" paid by the buyer, but also one-time cash "upfront points."

9. A CDO can be backed by bonds (a "cash CDO"), by CDS (a "synthetic CDO"), or by both bonds and CDS (a "hybrid CDO"). ACA 07-2 was a hybrid CDO. As was common with CDOs, ACA 07-2 was set up as an issuer organized under the laws of the Caymans Islands, with a board of directors in the Caymans, and with a co-issuer incorporated in Delaware and a director in Delaware.

The Roles and Obligations of ACA and UBS in ACA 07-2

10. UBS affiliates structured ACA 07-2 and acted as its warehouse provider and the initial CDS counterparty for the CDS collateral that went into ACA 07-2. A warehouse is essentially a credit line extended to the CDO before it launches to allow the CDO to acquire collateral while investors consider purchasing a tranche in the CDO. As the warehouse provider for ACA 07-2, UBS AG bore the risk of loss on the warehoused assets unless and until the CDO closed and UBS was able to sell the CDO notes to investors. As the initial CDS counterparty, UBS AG faced third parties on the CDS entered into for the ACA 07-2 warehouse; at closing UBS entered into offsetting CDS with ACA 07-2. UBS AG received a small intermediation fee for acting as the initial CDS counterparty. In the case of ACA 07-2, this fee was 2 basis points, so that, for example, if a third party agreed to pay a running spread of 300 basis points on a particular reference obligation, UBS AG would retain 2 basis points and transfer 298 basis points to the CDO. Finally, UBS earned any principal or interest paid by the collateral during the warehouse period; this is known as the "carry."

11. UBS, together with its affiliate UBS Limited, acted as arranger, placement agent, and initial purchaser of the notes and equity issued by CDO. UBS agreed in an engagement letter with ACA that, among other things, it would structure the CDO; advise the CDO in obtaining ratings on its notes; assist the CDO in preparing offering materials; formulate a marketing strategy for the CDO's securities; advise the CDO on negotiations with prospective investors; and use best efforts to place the CDO's securities. UBS and UBS Limited were entitled to a fee of approximately $10.8 million for these services.

12. ACA was the collateral manager for ACA 07-2. As collateral manager, ACA was responsible for selecting the collateral that went into ACA 07-2 and determining the price that the CDO would pay for that collateral (or, in the case of CDS collateral, the amount the CDO would be paid for selling protection). ACA owed a fiduciary duty to ACA 07-2 as its investment adviser. In addition to that duty, ACA was required to follow guidelines set out in certain documents governing the operation of the CDO. These included a "collateral management agreement," which was an investment advisory agreement between ACA and ACA 07-2, and the indenture, which was a document that governed the rights of investors in the CDO, among other things. The collateral management agreement required ACA to identify appropriate CDS to be acquired by the

CDO; to comply with the terms of the CDO's indenture affecting ACA's functions, including the investment criteria found in the indenture that set forth specific guidelines for qualified investments; and to seek to obtain best prices and executions when causing the CDO to acquire collateral. ACA represented to the CDO that all CDS purchased by the CDO at its closing satisfied all terms and conditions applicable to such purchases found in the indenture and collateral management agreement as of the date of purchase or, if earlier, the date of commitment. One requirement in the CDO's indenture was that transactions be conducted "on an arm's-length basis for fair market value." The CDO's offering circular also stated that CDS could only be acquired by the CDO if such CDS satisfied this arm's-length, fair-market-value requirement, but it allowed the transfer of collateral into the CDO at the same price that UBS paid during the warehouse period. ACA could fulfill its fiduciary duty to the CDO by determining the fair market value of the collateral at close and transferring the collateral into the CDO at such price, or transferring the collateral into the CDO at the price at which it was acquired for the warehouse. This second option was the industry standard for this type of CDO.

Solicitation Of Bids With Upfront Points

13. In early 2007, spreads on CDS referencing RMBS began to widen substantially. Certain market participants, including UBS, viewed these CDS as cheap because a protection seller could receive a substantially larger spread than it would have received in 2006 for selling protection on the same RMBS. Because UBS CDO desk employees believed that the RMBS market would improve and spreads would tighten, UBS and ACA began negotiations for what would become ACA 07-2.

14. In late March 2007, UBS employees asked ACA to begin ramping the CDO by acquiring CDS referencing RMBS with a preset running spread and upfront points. ACA then sent out BWICs to acquire collateral for inclusion in the CDO. Through the first three BWICs, by early April 2007 UBS acquired $297.5 million notional amount of CDS with running spreads of 300, 350, or 375 basis points and with upfront payments totaling approximately $28.9 million. The remainder of the CDS referencing RMBS for ACA 07-2 were ramped by May 14, 2007, but no other positions were acquired for ACA 07-2 using upfront points. Because two of the CDS needed to be unwound before the CDO closed, the total amount of upfront points collected during the warehouse dropped to approximately $23.6 million. The total notional value of the CDO's collateral when the CDO launched was $750 million.

UBS Keeps the Upfront Points

15. From the outset, UBS employees working on ACA 07-2 intended for UBS to retain the upfront points. Early in the structuring, the head of the U.S. CDO group at UBS stated: "Let's see how much money we can draw out of the deal." Similarly, the manager of UBS's CDO syndicate book stated that he viewed the ACA 07-2 CDO as an "arbitrage opportunity" — i.e., a chance for UBS to make trading gains when selling the assets into the CDO.

16. After the ACA 2007-2 CDO was partially ramped using CDS with upfront points, UBS employees discussed how to retain the upfront points. In early May 2007, those employees

discussed two ways in which UBS could do so: (1) UBS could contribute the upfront points to the CDO and arrange to have the CDO pay them back to UBS on a fully disclosed basis, or (2) UBS could simply keep the upfront points without disclosing their retention to prospective investors. At the request of the head of the U.S. CDO group, one of the UBS CDO group employees contacted the in-house UBS attorney assigned to the ACA 07-2 CDO ("Deal Counsel") to discuss whether UBS could retain the upfront points. Deal Counsel, apparently having identified a potential tax issue, then contacted an in-house UBS tax counsel and UBS's external tax counsel to discuss the desire of the UBS CDO group to retain the upfront points and the possible tax ramifications of doing so. All of these attorneys were informed of the CDO group's desire to retain these upfront points, and the fact that the CDS spreads without the upfront points were not representative of then-current fair market value. The undisclosed retention of the upfront points by UBS was inconsistent with how UBS had structured other CDOs, where upfront points, if they existed, were transferred to the CDO at closing. But neither Deal Counsel nor the other attorneys involved appear to have considered whether the retention of the upfront points needed to be disclosed to investors or to the other outside counsel working on the ACA 07-2 documentation. Ultimately, Deal Counsel signed off on the ACA 07-2 documentation and disclosures without suggesting to anyone that any amendment be made to the documents to address UBS's retention of the upfront points.

17. ACA employees were aware that UBS would not transfer the upfront points to ACA 07-2. During the ramp of this CDO, employees from ACA and UBS discussed in telephone conversations recorded at ACA whether UBS would transfer all, some, or none of the upfront points to the CDO. In one conversation, an ACA employee said that UBS would transfer the CDS to the CDO at a "mid-market" price and keep the rest of the upfront points (even though the price was not "mid-market" at the time). In another conversation about the upfront points, an ACA employee asked: "Is there, uh, 20 million dollars lying around?" The UBS employee responded: "There's no 20 million. . . . We spent it already." Finally, after a prospective investor learned of the existence of the upfront points, he was told by an ACA employee that UBS was keeping those upfront points as a "hedge" for itself.

UBS and ACA Fail to Disclose that UBS Kept the Upfront Points

18. The offering circular for ACA 07-2 stated that the CDO had to acquire all collateral "on an 'arm's-length basis' for fair market value." The CDO's indenture contained the same requirement, and ACA's collateral management agreement required it to seek best execution on behalf of the CDO. UBS and ACA together prepared an asset list in connection with UBS's effort to market the CDO to investors beginning in mid-May 2007. The asset list was distributed to prospective investors, and it did not contain any reference to the upfront points. Similarly inaccurate information later was provided to the CDO's directors. In addition, the marketing materials disclosed a fee to UBS of approximately $10.8 million, but made no reference to the $23.6 million in upfront points being retained by UBS.

19. UBS also failed to disclose its retention of the $23.6 million in upfront points in communications with prospective investors, with two exceptions. On both of these occasions, the

disclosure came only after the investor specifically questioned the information UBS had disclosed about its economic benefit from the deal.

20. UBS received its first commitments from investors to purchase ACA 07-2 CDO notes in early June 2007. UBS ultimately was able to sell only $186 million face value of the CDO's securities to 9 investors, for which UBS actually received $153 million because of discounts offered on such securities. UBS retained approximately $598 million of the CDO's securities, including a $375 million super senior note, approximately $188 million in junior notes, and $35 million of the CDO's equity securities. Only four months after it closed, ACA 07-2 issued a notice of default, as a result of the deterioration of the subprime mortgage-backed securities market, and ratings agency downgrades of thousands of RMBS bonds, including bonds referenced in ACA 07-2. At the time the CDO was liquidated in June 2008, outside investors lost approximately $130 million on their investments in this CDO.

21. In connection with ACA 07-2, UBS retained approximately $23.6 million in undisclosed upfront points, a disclosed fee of approximately $10.8 million, and the warehouse carry.

Violations

22. As a result of the conduct described above, UBS willfully violated Sections 17(a)(2) of the Securities Act, which prohibits any person from "obtain[ing] money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading," and willfully violated Section 17(a)(3) of the Securities Act, which prohibits any person from "engag[ing] in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser."[2]

23. As a result of the conduct described above, UBS also negligently caused ACA's violations of Section 206(2) of the Advisers Act, which prohibits investment advisers from engaging in any transaction, practice, or course of business that defrauds clients.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent UBS's Offer.

Accordingly, pursuant to Section 8A of the Securities Act, Section 15(b)(4) of the Exchange Act, and Sections 203(e) and 203(k) of the Advisers Act, it is hereby ORDERED that:

2 A willful violation of the securities laws means merely "'that the person charged with the duty knows what he is doing.'" *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000) (quoting *Hughes v. SEC*, 174 F.2d 969, 977 (D.C. Cir. 1949)). There is no requirement that the actor "'also be aware that he is violating one of the Rules or Acts.'" *Id.* (quoting *Gearhart & Otis, Inc. v. SEC*, 348 F.2d 798, 803 (D.C. Cir. 1965)).

A. Respondent UBS cease and desist from committing or causing any violations and any future violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act and Section 206(2) of the Advisers Act.

B. Respondent UBS is censured.

C. Respondent UBS shall, within 30 days of the entry of this Order, pay disgorgement of $34,408,185, prejudgment interest of $9,719,002.24, and a civil money penalty of $5,655,000 to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600 and to 31 U.S.C. § 3717. Payment must be made in one of the following ways:

(1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;

(2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or

(3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying UBS Securities LLC as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Robert Keyes, Securities and Exchange Commission, New York Regional Office, 3 World Financial Center, Suite 400, New York, NY 10281. All disgorgement, prejudgment interest, and civil money penalty payments made by UBS pursuant to the Order, and any future funds collected from UBS by the Commission related to the Order, including any interest payments, will be transferred to the United States Treasury.

By the Commission.

Elizabeth M. Murphy
Secretary