

THE COMMONWEALTH OF MASSACHUSETTS
OFFICE OF THE SECRETARY OF THE COMMONWEALTH
SECURITIES DIVISION
ONE ASHBURTON PLACE
BOSTON, MASSACHUSETTS 02108

IN THE MATTER OF:

UBS Securities, LLC,

Respondent

ADMINISTRATIVE
COMPLAINT

Docket No. E-2007-0049

ADMINISTRATIVE COMPLAINT

I. PRELIMINARY STATEMENT

SECRETARY OF THE COMMONWEALTH
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SECURITIES DIVISION

The Enforcement Section of the Massachusetts Securities Division of the Office of the Secretary of the Commonwealth (respectively "Enforcement Section" or "Division") files this Administrative Complaint ("Complaint") in order to commence an adjudicatory proceeding against the above-named Respondent for violating the Massachusetts Uniform Securities Act, M.G.L. c. 110A ("Act") and relevant regulations, 950 C.M.R. 10.00 *et. seq.* ("Regulations"). The Enforcement Section seeks an Order of the Division: 1) requiring Respondent to permanently cease and desist from violating the Act and Regulations; 2) censuring Respondent; 3) requiring Respondent to pay an administrative fine in an amount and upon such terms as the Director or Hearing Officer may determine; and 4) taking such further action as may be deemed just and appropriate by the Director or Hearing Officer for the protection of investors.

II. SUMMARY

UBS Securities LLC has been providing gifts and gratuities to the advisers for certain hedge funds, including below market rent, personal loans with below market interest rates, and tickets to sporting events and other entertainment events. These gifts and gratuities have been provided in order to induce those advisers to increase or retain lucrative prime brokerage fees resulting from those hedge funds.

Other than hedge fund advisers, prime brokers are the primary third party service providers to hedge funds. Prime brokers provide a suite of services essential to the successful implementation of hedge funds' individual objectives. Prime brokers generate substantial revenue from those hedge fund clients in exchange for these services. UBS competes for prime brokerage revenue in part by providing a range of benefits to the advisers of those hedge fund clients to induce the advisers to bring and keep the hedge fund business with UBS. Among the methods UBS used to influence or reward hedge fund advisers and their principals are:

- Provision of office space to hedge fund advisers at rates that are substantially below market rate;
- Free access to information technology personnel and other office personnel;
- Introductions to potential new clients (that would increase management fees for the adviser);
- Low interest personal loans; and
- Tickets to sporting events and other forms of entertainment.

Unbeknownst to the pension funds, university endowments, charitable foundations, institutional investors and individuals who invest in hedge funds, the rewards for the hedge fund advisers come with implicit and sometimes explicit *quid pro quos*. UBS requires the hedge fund advisers

to cause the hedge funds they manage to meet certain benchmarks of profitability for UBS or ensure they do not use other prime brokers.

UBS withdraws gifts and gratuities from hedge fund advisers when they do not direct the hedge funds they manage to generate sufficient revenue for UBS. Members of the UBS Prime Brokerage Group create quarterly "non-profitable client" reports and meet to discuss which hedge funds are insufficiently profitable to UBS. These meetings are to discuss how to ensure they will generate additional revenue for UBS. In one instance, a hedge fund adviser who refused to alter his trading strategy to meet UBS's demand for greater revenue was no longer welcome in UBS office space.

These practices are standard operating procedure within UBS Prime Services. Certain employees are devoted to managing relationships with hedge fund advisers and coordinating the benefits. When certain "top" hedge fund advisers request special benefits, such as personal loans at below market rates, UBS goes out of its way to accommodate them. In one instance, the department within UBS charged with providing loans to individuals had rejected the loans and the UBS staff charged with assessing credit risk expressed serious reservations about them. UBS nevertheless circumvented its own policies and procedures and extended the loans to the principals of the adviser to the hedge fund. Even though the "out-of-policy" loan required the approval of the Chairman and Chief Executive of the UBS Investment Bank, that approval was provided long after the loan was extended. In fact, approval was granted just days before the loan was repaid. Providing personal loans at below market rates are gifts or gratuities.

UBS is required to track the provision of such gifts and gratuities to ensure that they do not violate rules regarding the provision of such inducements. Requirements limiting gifts and gratuities exist (a) to make sure the fiduciary duty of advisers to act in the best interests of their

clients is not subverted by the provision of gifts and gratuities, and (b) to make sure that a benefit, earned by the client (in this case the hedge funds) is not improperly given to the agent making decisions on behalf of the client. However, the Division's investigation revealed that UBS does not undertake proper supervision of the gifts and gratuities it provides to favored hedge fund advisers nor does it maintain the required records to assess and determine whether its provision of gifts and gratuities exceeds the allowable levels. UBS in its Code of Ethics states, "[w]e do not provide... improper inducements in the course of our business dealings with others." UBS nevertheless provides these gifts and gratuities specifically to induce advisers to hedge funds to commit the hedge fund assets they manage to prime brokerage relationships with UBS. When asked under oath about some of the benefits they received from UBS, a number of the principals of hedge fund advisers either denied their existence or could not recall having received them.

UBS's predecessor in the prime brokerage business, ABN Amro signed a Memorandum of Understanding with the Massachusetts Securities Division in 2002, whereby it would ensure that all state registered investment advisers that received discounted office space would disclose it to their investors. UBS did not adhere to the terms of that Memorandum of Understanding, as the only state registered investment adviser that currently receives discounted space from UBS does not disclose the provision of that space to its investors.

The activities as described above violate the regulations promulgated under applicable rules regarding gifts and gratuities and thus constitute dishonest and unethical acts. These acts were exacerbated by UBS's failure to properly supervise its agents and violations of relevant rules relating to the retention of books and records.

III. JURISDICTION & AUTHORITY

1. The Massachusetts Securities Division is a division of the Office of the Secretary of the Commonwealth with jurisdiction over matters relating to securities, as provided for by the Act. The Act authorizes the Division to regulate: 1) offers and/or sales of securities; 2) those individuals and entities offering and/or selling securities; and 3) those individuals and entities transacting business as investment advisers within the Commonwealth.
2. This proceeding is brought in accordance with the Act and its Regulations. Specifically, the acts and practices constituting violations occurred primarily in the Commonwealth of Massachusetts.
3. The Division allows this action pursuant to the enforcement authority conferred upon it by section 407A of the Act and M.G.L. c. 30A, wherein the Division has the authority to conduct an adjudicatory proceeding to enforce the provisions of the Act and all Regulations and rules promulgated thereunder.
4. The Enforcement Section specifically reserves the right to amend this Complaint and/or bring additional administrative complaints to reflect information developed during the current and ongoing investigation.

IV. RELEVANT TIME PERIOD

5. Except as otherwise expressly stated, the conduct described herein occurred during the approximate period of January 1, 2002, through the present.

V. RESPONDENT

6. UBS Securities, LLC, ("UBS") is a registered broker-dealer and investment adviser with Central Registration Depository ("CRD") number 7654. One of UBS's divisions is the UBS Investment Bank, and within the UBS Investment Bank is UBS Prime Brokerage Services.

VI. OTHER RELATED PERSONS OR ENTITIES

7. Michael Torrisi, ("Torrisi") is a natural person, currently employed as an Executive Director of UBS Prime Brokerage Services, with a CRD number of 2794689. Torrisi is registered with the Division as an agent of UBS.
8. Par Capital Management, Inc. ("PAR") is a Delaware Corporation, registered as a Foreign Corporation with the Massachusetts Corporations Division since May 26, 1992, and maintains a registered office in the Commonwealth at One International Place, Suite 2401 in Boston. Upon information and belief, four principals including Paul Reeder and Ed Shapiro own PAR. PAR serves as the general partner of the PAR Group LP, a Delaware limited partnership. PAR Group LP serves as the general partner of PAR Investment Partners LP, a Delaware limited partnership. PAR Investment Partners LP is a hedge fund.
9. Paul Reeder ("Reeder") is a natural person, is a stockholder of Par Capital Management, and serves as its President and a Director of Par Capital Management.
10. Edward Shapiro ("Shapiro") is a natural person and was a stockholder of Par Capital Management Inc. for at least a portion of the relevant time period.
11. Feingold O'Keeffe LLC ("Feingold O'Keeffe") is a Delaware Limited Liability Company organized to do business in the Commonwealth as a Foreign Limited Liability

Company on November 2, 2001. Feingold O'Keeffe is a federally covered adviser registered with the Securities and Exchange Commission and notice-files with the Division, with a CRD number of 137523. Feingold O'Keeffe serves as the adviser to the following hedge funds: Feingold O'Keeffe Capital I Offshore, Ltd., Feingold O'Keeffe Capital I (QP), L.P., Feingold O'Keeffe Capital I, L.P., Feingold O'Keeffe Credit Value Fund, L.P., Feingold O'Keeffe Credit Value Fund, Ltd., Feingold O'Keeffe Credit Value Master Fund, Ltd., Feingold Select Opportunities Master Fund (Cayman), L.P., Feingold Select Opportunities, Ltd., Feingold Select Opportunities Fund LP, Avery Street CLO, Ltd., and Emerson Place CLO, Ltd.

12. Robert Ian O'Keeffe ("O'Keeffe") is a natural person with a CRD number of 2318747, and is a manager of Feingold O'Keeffe LLC.
13. Delta Partners LLC ("Delta") is a federally covered adviser registered with the Securities and Exchange Commission and is a notice-filer with the Division. Delta has a CRD number of 114681. Along with its affiliated entities, Delta Advisors LLC and Delta Investment Partners LLC, Delta advises and/or administers the following hedge funds: Prism Partners LP, Prism Offshore Fund, Ltd., Delta Sapphire Fund of Funds LP, Delta Gems LP, and Delta Gems Offshore Fund, Ltd.
14. ABN Amro Incorporated ("ABN Amro") is a New York Corporation with a CRD number of 15776. ABN Amro is a broker-dealer registered with the NASD, Massachusetts and various stock exchanges and other states.

VI. STATEMENT OF FACTS

A. Hedge Fund Advisers are Fiduciaries for the Hedge Funds They Manage

15. Hedge Funds are entities that hold pools of securities and perhaps other assets, whose interests are not sold in a registered public offering and are not registered as investment companies under the Investment Company Act of 1940.
16. Hedge Fund advisory firms ("Hedge Fund Advisers") manage hedge funds. Traditionally, investors place significant assets in the care of a Hedge Fund Adviser. In exchange for the expectation of high returns or the realization of other objectives, investors in hedge funds typically pay Hedge Fund Advisers a 2% annual management fee ("Management Fee") as well as 20% of the profits of the fund ("Performance Fee").
17. Hedge Fund Advisers are investment advisers under federal law and are often exempt from registration under state or federal law.
18. The responsibilities of Hedge Fund Advisers to the hedge funds do not end with managing the hedge fund assets. In Regulation of Investment Advisers, 2007 Edition, Thomas P. Lemke and Gerald T. Lins wrote about the duties of investment advisers:

As a fiduciary, an adviser owes its clients more than honesty and good faith alone. Rather, an adviser has an affirmative duty of utmost good faith **to act solely in the best interests of the client and to make full and fair disclosure of all material facts**, particularly where the adviser's interests may conflict with the client's. (*emphasis added*)
19. Hedge Fund Advisers are agents of hedge funds and act in a fiduciary capacity with respect to the hedge funds they manage.
20. The principals of Hedge Fund Advisers are typically the owners of the Hedge Fund Adviser. Accordingly, Hedge Fund Adviser principals are beneficiaries when anything of value is provided to the Hedge Fund Adviser of which they are employees or principals.

B. Relationships Between Prime Brokers And Hedge Funds

i. UBS is a Prime Broker

21. "Prime Brokerage" is a service provided by certain broker-dealers to facilitate the clearance of securities trades and other services to substantial retail and institutional customers, including hedge funds. The services offered by Prime Brokers may include: trading; securities lending; margin lending; customized reporting; research; valuation; technology; operations services; and other services needed by hedge funds or other large clients.
22. Prime Brokers generate revenue on hedge fund business from commissions, spreads, administrative fees, ticket charges, stock loans and credit interest earned from providing position financing and arranging securities loans ("Prime Fees").
23. In the Prime Brokerage relationship, the client who pays the Prime Fees is the hedge fund. The Hedge Fund Adviser is an agent of the hedge fund, acts on behalf of the hedge fund and has fiduciary duties to the hedge fund.
24. ABN Amro entered into the Prime Brokerage business prior to 2002. At that time, ABN Amro engaged in various practices to recruit hedge funds to use its Prime Brokerage business.
25. ABN Amro offered Hedge Fund Advisers discounted office space and various other hedge fund startup services to recruit hedge funds to use its Prime Brokerage business.
26. It is typically the obligation of the Hedge Fund Adviser to pay for its own office space.
27. During early 2002, the staff of the Massachusetts Securities Division learned that ABN Amro was providing discounted rent to Hedge Fund Advisers, and that the Hedge Fund Advisers were not disclosing to rental arrangement to their investors.

28. On or about April 10, 2002, the Massachusetts Securities Division entered into an Agreement and Acknowledgement of Undertakings Between the Massachusetts Securities Division and ABN Amro Securities, LLC ("Undertakings"). The Undertakings required ABN Amro to ensure that Massachusetts registered investment advisers provided written disclosure to their clients if the advisers had both prime brokerage agreements with ABN Amro as well as licensed office space from ABN Amro. See Exhibit A.
29. On or about December, 2003 UBS acquired ABN Amro's Prime Brokerage business.
30. Since UBS acquired ABN Amro's Prime Brokerage business, UBS has been obligated to comply with the Undertakings.
31. UBS has a Code of Business Conduct and Ethics that it makes available to all visitors to its website where it promises, "We do not provide or accept improper inducements in the course of our business dealings with others." See Exhibit B.

ii. Conflicts of Interest in the Prime Brokerage Business

32. The Prime Brokerage business generates substantial revenue for UBS.
33. According to the February 2007 edition of the publication "Euro Hedge," in 2006, UBS had the largest growth in assets from new clients of all Prime Brokers.
34. In order to attract and retain hedge fund clients of its Prime Brokerage business, UBS employs a team of people within its Equities Division. Michael Torrisi, Executive Director of UBS Prime Brokerage Services, acts as a relationship manager for Prime Brokerage clients in the New England region.
35. Torrisi's job is to market UBS's Prime Brokerage services in the New England region. In his own words, "I'm responsible for that relationship. So I am, as I stated before, I'm

aware of typically most things that are going on as far as UBS business matters with that client."

36. Prime Brokerage revenue is generated from hedge funds and ultimately comes from hedge fund investors. Hedge Fund Advisers decide which and how many transactions to engage in, and which Prime Brokers to use to facilitate those transactions.
37. The UBS personnel interviewed by the Division expressed uncertainty as to whether the Prime Brokerage client was the hedge fund or the Hedge Fund Adviser.
38. Although he was the North American Head of Capital Introduction until March, 2007 and currently is Co-Head of Sales for the Americas, Howard Eisen did not know whether his clients were the hedge funds whose assets were custodied at UBS and generated fees for UBS or the Hedge Fund Advisers:

That's an interesting question and until you -- **until now I don't think I've ever even thought about the difference between the two.** You know, I'm sure that there is a legal definition of who our actual counterpart is; I actually don't know sitting here right now who that would be in legal terms. In practical terms, I guess I kind of view them all as being one entity, one unit and, you know, whomever the portfolio manager or the head of the hedge fund or hedge fund firm is that gets to decide, you know, where the prime brokerage mandate resides, that's the individual that ends up being the client in my eyes from a business perspective.
(emphasis added)

39. When a Prime Broker provides various services or benefits to a Hedge Fund Adviser in exchange for that adviser having the hedge fund engage in transactions with or through UBS, a conflict arises that may detrimentally impact fund investors.
40. UBS has not engaged in an adequate analysis of conflicts of interest that might arise from the provision of gifts and gratuities to Hedge Fund Advisers.
41. UBS does not have adequate safeguards in place to prevent gifts and gratuities from creating conflicts of interest or violating applicable securities laws.

42. When confronted with this conflict of interest, deliberately created to generate business,

Eisen responded:

...it's essentially the hedge fund manager's job, responsibility, obligation, what have you, to make sure that if there's any conflicts that arise between him and his investors or her investors to make sure that those were properly mediated and it wasn't really our-- **one of those parties has a contractual account relationship with us, one of them doesn't and so their own issues are their own issues, that's number one.** (*emphasis added*)

iii. Discounted Rent

43. UBS maintains high-end office space, in the heart of Boston's financial district, at One International Place and Two International Place for use by certain Hedge Fund Advisers ("Resident Advisers").
44. The developer of One International Place describes the lobby on its website as, "[w]ithin the courtyard, building patrons meet and relax amid full-sized trees, an inspiring ceiling-to-floor waterfall, and the many restaurants and retail shops. Ionic marble columns surround the lobby's perimeter and enhance the building's classic opulence."
45. The office space arrangement between UBS and Hedge Fund Advisers is a licensing arrangement rather than a rental arrangement.
46. Most, if not all of the cost of building out the Resident Adviser's office space is typically paid by UBS.
47. Most Resident Advisers pay a real estate licensing fee to occupy office space provided to them by UBS.
48. On information and belief, no Resident Adviser has paid UBS market rates for office space during the relevant time period.
49. The office space-licensing fee UBS charged to Resident Advisers ranged between \$35 per square foot per year and \$52 per square foot per year during 2006.

50. An internal memorandum at UBS set a goal of raising rent on "all those space clients who are not paying Market rent by April 1, 2006."
51. According to an attachment to an internal e-mail, from the US Head of Client Relationship Management to the US Head of Real Estate Services, as of December 2005, the market rate per square foot of office space at One International Place was \$72 per square foot ("Market Rate").
52. On information and belief, the \$72 per square foot Market Rate determined by UBS includes market adjusted base rent, operating expenses, real estate taxes, utilities, building maintenance, depreciation charges, cost of furniture, information technology services, facilities costs as well as the benefit of obtaining prime office space on a month-to-month basis.
53. Torrasi testified that in approximately March, 2005, there was a push by "Senior Management" to get a consistent rate for license fees and that UBS did not have written license agreements with Resident Adviser Advisers prior to March, 2005.
54. Torrasi testified that UBS attempted to get \$52 per square foot from Resident Advisers ("Uniform Rate").
55. UBS notes relating to the rent increases and attempts to generate consistent rates indicated that charging the Uniform Rate of \$52 per square foot would represent a 25% loss to UBS.
56. As of June 2006, no Resident Advisers were paying the Market Rate for office space at One International Place.

a. Additional Discounts to Remedy Errors in Prime Brokerage Services

57. UBS made exceptions to the Uniform Rate for Hedge Fund Advisers when UBS failed to perform adequately with respect to the hedge funds they managed.
58. When asked what the factors were that determined which funds would not pay the Uniform Rates, John Laub, the Chief Administrative Officer for Prime Services, replied, "If I recall, the -- the issues were related to -- we had client service issues already with those clients, in terms of service delivery, and the -- we had decided at that point we wouldn't want to raise their rates until we, kind of, resolved those issues and gotten past that."
59. Delta's Chief Operating Officer, cited service issues with the UBS accounting platforms that led to a situation where "...the auditors were asking for certain information and we couldn't provide it to them."
60. Paul Reeder stated that with PAR, "[t]here was an issue with proxies that we weren't receiving our proxies on companies that we own shares in" and additional issues "with regard to the error rates on - on the account reports."
61. According to an e-mail between a PAR employee and Torrasi, as of May 4, 2006, UBS had been using the wrong rates to calculate how much money UBS would pay PAR when it borrowed from PAR and how much PAR would pay UBS when PAR borrowed from UBS.
62. When the Division questioned Torrasi regarding the service issues, he attributed the lack of an increase in rent due to UBS "[h]aving - we were having some - as I've put it, operational issues with PAR in regards to their account and the way things were being processed. So you know, we weren't - we just weren't operating efficiently on their account at this point."

63. Torrissi further defined the "operational issues" as "[n]ot processing some of their trades correctly. Not looking at their leverage correctly. Not calculating the leverage correctly. Some of the reporting was off. Some of the money line balances were off" and stated that the decision not to raise PAR's rent was "[a] business decision not to push a rent increase to them based on the inefficiencies we were having on the operational side."
64. Instead of addressing the service issues and harm suffered by the funds with compensation that would benefit the hedge funds and the hedge fund investors, UBS chose instead to provide a benefit to the Hedge Fund Adviser by not raising their rents.
65. When UBS fails to properly process transactions in hedge fund accounts, harm may be inflicted upon the hedge fund. Discounts on rent solely benefit the Hedge Fund Adviser and do not compensate the hedge fund for any trade or account processing issues.
66. As of April 18, 2007, Delta was paying \$40 per square foot, substantially below the Uniform Rate and the Market Rate.
67. As of April 18, 2007, PAR was paying \$35 per square foot, substantially below the Uniform Rate and the Market Rate.

b. UBS Incurs Losses on Real Estate Operations

68. UBS uses a document entitled the "Tenant Profitability Report" to compare the costs associated with each Resident Adviser with the revenues generated by the hedge fund it advises.
69. UBS describes the field entitled "Net Rent" on the Tenant Profitability Report as:

Net Rent: This is the rent UBS pays the landlord less the fee charged to the client for the use of office space. The rent paid for the client's office space is determined by multiplying the percentage of the total floor used by the client by the total rent paid by UBS for that floor. The percentage of total floor space used by the client

is the updated percentage, not necessarily the number that appears as "% of Total Floor Usable.

70. Between January 1, 2004 and December 31, 2004, UBS accrued total losses on office space of \$431,387.
71. Between January 1, 2004 and December 31, 2004, sixteen Hedge Fund Advisers were provided with office space by UBS, each with office space discounts valued more than \$1,000 below UBS's cost for that time period.
72. Between January 1, 2004 and December 31, 2004, four Hedge Fund Advisers were provided with office space by UBS, each with discounts valued more than \$20,000 below UBS's cost for that time period.
73. Between January 1, 2005 and December 31, 2005, UBS accrued total losses on office space of \$530,222.
74. Between January 1, 2005 and December 31, 2005, seventeen Hedge Fund Advisers were provided with office space by UBS, each with discounts valued more than \$1,000 below UBS's cost for that time period.
75. Between January 1, 2005 and December 31, 2005, six Hedge Fund Advisers were provided with office space by UBS, each with discounts valued more than \$20,000 below UBS's cost for that time period.
76. Between January 1, 2006 and December 31, 2006, UBS accrued total losses on office space of \$441,940.
77. Between January 1, 2006 and December 31, 2006, nineteen Hedge Fund Advisers were provided with office space by UBS, each with discounts valued more than \$1,000 below UBS's cost for that time period.

78. Between January 1, 2006 and December 31, 2006, three Hedge Fund Advisers were provided with office space by UBS, each with discounts valued more than \$40,000 below UBS's cost for that time period.

c. Free Temporary Space

79. UBS has at times permitted Resident Advisers to occupy office space on a "Temporary" basis.
80. When asked how it was determined which clients UBS charges for use of temporary space, Torrasi replied, "Well, in the instance of clients that do pay for temporary space, they've chosen to pay for it."
81. According to Torrasi, at least one client occupied office space on a temporary basis without being charged for a period of five or six months.

iv. Additional Services to Benefit Resident Advisers

82. In addition to the office space provided at substantially below-market terms, UBS provides Resident Advisers with a broad range of services for which UBS does not charge.
83. Those ancillary benefits include: office furniture; a full-time receptionist (who is shared among the Resident Advisers); internet access; data network providers; full-time information technology support ("IT Support"); a constantly filled pantry; and free meals, including daily breakfast and lunch on Fridays.
84. Other benefits include business consulting services to assist Hedge Fund Advisers with their non-trading and non-research capabilities, infrastructure, referrals to lawyers and accountants, and operational assistance.

85. UBS does not and has not charged Resident Advisers for the services referenced in the preceding four paragraphs.
86. When asked which Prime Brokerage-related services UBS charges for, Laub said, "some of the services – capital introduction, business consulting, effectively we don't charge for the client service and the reporting process." He further elaborated that business consulting is, "their non-trading non-research capabilities, their infrastructure... it would be a whole host of services related to that to try to help the hedge fund better manage their business."
87. The vast majority, if not all, of the services UBS provides to favored clients for free, as described by Laub, are services that accrue to the benefit of the Hedge Fund Adviser rather than the hedge fund client itself.

v. License Agreements and Deal Letters

88. Because office space and ancillary services are provided without charge or at below-market rates to Hedge Fund Advisers, UBS expects the Hedge Fund Advisers to cause their hedge fund clients to take certain actions in connection with those benefits.
89. In connection with the licensing arrangement described above, UBS has at times required Resident Advisers to sign "License Agreements" and provided "Deal Letters" to the hedge funds the Resident Advisers advised.
90. In order to obtain executed License Agreements from its Resident Advisers, UBS personnel e-mailed one Resident Adviser using the following language:
- "Enclosed find attached your updated Office Space Agreement/Terms and Conditions. Please sign and return this to us urgently"
91. Another Resident Adviser was sent the following:

"I am sorry to pester you about this, but we are going through an audit and we urgently need to receive these docs back from you."

92. UBS personnel e-mailed several License Agreements to Resident Advisers for execution, which were dated prior to the date they were sent.
93. The License Agreements UBS provided to its clients included sample disclosures to existing and future hedge fund investors regarding the provision of office space as well as requested that Hedge Fund Advisers provide copies of those disclosures to UBS.
94. UBS did not obtain disclosure documents relating to the provision of office space from all Resident Advisers.
95. Hedge Fund Adviser Feingold O'Keeffe did not disclose to investors in the hedge funds it managed that it received office space from UBS at below Market Rates in either its Offering Memoranda or Form ADV Part II.
96. On information and belief, Feingold O'Keeffe did not disclose, in any document, to investors in the hedge funds it managed that it received office space from UBS at below-Market Rates.
97. In at least one instance, a Resident Adviser negotiated with UBS to ensure it was not receiving below market rates for office space.
98. According to one Resident Adviser that negotiated office space licensing fees with UBS, "when they told us it was \$52 a square foot, we said okay, are you sure, are we paying for everything, and we were assured that we were, and then when we looked at things such as what Class A space was renting for at the time in Boston, their response seemed reasonable to us."

99. As a result of UBS's incorrect representation that the Resident Adviser's office space was being provided at Market Rate, the Resident Adviser provided disclosures that did not indicate that it received office space at less than Market Rates.

vi. Quid Pro Quo

100. Providing benefits to Hedge Fund Advisers with explicit or implicit requirements relating to how those advisers manage hedge fund assets creates a conflict of interest.

a. Discounted Rent Tied to Prime Fees

101. As a condition for receiving office space at below-market rent and the other services described above, Resident Advisers are expected to direct a certain amount of hedge fund business to UBS.
102. With respect to one Hedge Fund Adviser that was considering becoming a Resident Adviser of UBS, an internal e-mail stated "although there is no specific, formal tie in, they are v much aware of the implied expectation of continued growth of their existing and new bsns with UBS." (*sic*)
103. For example, during rate negotiations between PAR and UBS, Reeder sent an e-mail to Torrisi saying: (See Exhibit C)¹

I realize that relative to the rates we currently are paying, these new rates will cause a material drop in our revenue to UBS. While we would like to be a more important client rather than a less important one, I hope you will take the following facts into consideration as you process this request:...

... Par clearly has been over-paying and under-receiving interest relative to market rates for some period of time, and we believe we are entitled to some significant rate relief at this juncture. (*emphasis added*)

¹ The Enforcement Section has made partial redactions on exhibits in order to avoid disclosure of proprietary business information.

104. During those rate negotiations, Torrasi sent an e-mail to a Managing Director of UBS

Prime Brokerage Services recounting: (See Exhibit D)

PAR pricing, waiting to hear back. Explained to Paul that with his pricing [redacted] **could potentially make them not a top client**. He understood that and thought it was a good point; and was going to bring it to the other partners and get back to us. (*emphasis added*)

105. On March 16, 2006, Laub wrote about PAR,

Its perfectly reasonable to explain to them that their ranking will drop. **We don't need to be explicit but I think smart clients think about it**. For example, they are 66th in the division right now. They will be roughly 121st if they go to the new pricing. (*emphasis added*)

106. In another example, on January 3, 2005, in an internal e-mail regarding a Prime Fee renegotiation with Delta, Torrasi discussed that UBS's ability to provide better Prime Brokerage rates to the hedge fund was compromised by the provision of below market office space to the Hedge Fund Adviser. "I explained to them that we cannot compete w/ other PB's or with what other Hedge Funds have, because we carry a much higher overhead w/ space... They have [redacted] w/ us now. They have [redacted] fund w/ B of A, that I told them they would need to bring over to us." See Exhibit E.

107. In another e-mail during the same January 3, 2005 negotiation, Torrasi stated, "they realize we need to generate high revs for the amount of space they take."

108. During the negotiation of Deal Letters between UBS and Resident Advisers, in at least one circumstance, the real estate license fee paid by the adviser was increased specifically to offset the reduction of Prime Fees paid by the hedge fund.

109. The principal of a Resident Adviser described his deal letter negotiations with UBS as, "The essence of what I said was 'We should be paying [redacted] cents.' That's what we

pay now. If you have to jack the rent to get that [redacted] cents, go ahead and do it. I want a better short rebate than [redacted] percent."

110. A draft deal letter and the final executed deal letter for that Resident Adviser indicated that UBS raised the office space license fee charged to the Resident Adviser when the adviser demanded that the hedge fund's Prime Fees be reduced.
111. The principal of that Resident Adviser stated that he negotiated these rates solely with Torrisi.
112. Torrisi, after testifying that there is "no correlation" between prime brokerage and office spaces rates, answered that he "can't recollect an instance of..." where the licensee fee for office space was negotiated together with or traded off Prime Fees.
113. According to an e-mail from Laub, "[r]aising their [PAR's] rent to market gains us an extra \$160k and of course has other benefits.

b. Discounted Rent Tied to High Revenues

114. The Deal Letters outline the terms of the Prime Brokerage and office space licensing arrangements between Resident Advisers and UBS. Among the terms of the Deal Letters was a provision "requesting" that the Resident Adviser execute a minimum percentage of the hedge fund equity and option transactions with UBS. The Deal Letters are also conditioned on the hedge fund maintaining a minimum asset value with UBS.
115. According to internal UBS e-mails, Resident Advisers must ensure their hedge funds generate minimum revenues of \$150,000 per Resident Adviser for UBS. According to the e-mail, Resident Advisers that failed to meet the minimum revenue expectations were asked to increase fund activities that generate revenue to UBS or are asked to leave the office space at One or Two International Place.

116. According to internal UBS e-mails, non-Resident Hedge Fund Advisers must ensure their hedge funds generate minimum revenues of \$100,000 for UBS. See Exhibit F.
117. At least one Resident Adviser, Feingold O'Keeffe, discussed with UBS ways to increase the amount of Prime Fees it paid to UBS so it could continue being a Resident Adviser.
118. Hedge funds advised by Resident Adviser, Feingold O'Keeffe generated a total amount of in Prime Brokerage fees for UBS in 2006 that was below the minimum revenues of \$150,000 for Resident Advisers of UBS.
119. In November, 2006, Torrasi requested a meeting with Ian O'Keeffe to discuss how he might generate additional revenue for UBS. O'Keeffe responded by e-mail that "**I guess the real challenge is to figure out how we can change the profile**, leverage is an issue given the advance rates on our collateral, we have tried to up the use of UBS equity platform. What might help me is if you have any color on how any non-equity guys are generating fees. As well, we are in the process of ramping up our exposure to our UBS swap program." (*emphasis added*) See Exhibit G.

c. Penalties for Advisers Who do not Deliver

120. On the issue of whether to raise rent for two Resident Advisers who were not performing up to minimum expectation or covering UBS costs, Torrasi wrote, "I think if we raise the rent we are not going to get a lot out of it. **Either we kick them out now or give them 6-9 months and tell we need try to get more revenue...**" (*emphasis added*)
121. Ultimately, UBS removed one of those two Hedge Fund Advisers from its original office space to a smaller space in order to provide additional room for one of its largest and most profitable Resident Advisers. The smaller space was provided to one Resident

Adviser without charge pending that adviser moving out of the UBS office space permanently.

122. Hedge Fund Advisers are not always willing to accept UBS's directives to increase Prime Brokerage revenue. Regarding negotiations with one Hedge Fund Adviser, Torrasi wrote, "I spoke to them in regards to the low p&l and to see what we could do to improve it. The principle [redacted] was extremely upset by this, and is threatening never to do business with UBS again." (sic)
123. According to that Hedge Fund Manager, he was not meeting the "close to \$1 million in commissions" that Torrasi had originally told the Manager he hoped for, Torrasi characterized the firm as an "opportunity cost" and told him that UBS was "losing money on us."
124. According to that Hedge Fund Manager, "You know, they offered, when we traded with them, they offered best execution, and when we didn't, somebody else was. It seemed to me that, you know, balancing our responsibility to clients, that during that time frame, we did, in balancing those interests, what we could do with UBS, and I didn't want to go to great lengths to do any more trades with UBS just to satisfy them because we have to worry about the clients. So, when we came to that impasse, I left."

vii. Top Clients and Personal Loans

125. Resident Advisers that cause their hedge funds to generate particularly high revenue for UBS and meets the firm's expectations are considered "top clients."
126. Torrasi considers PAR to be a top client because they "produce a good amount of revenue for us."
127. UBS is the only Prime Broker used by the hedge funds managed by PAR.

128. According to Torrissi's testimony, in addition to the to the benefits described above, the benefits of being a top client include detailed oversight and early reporting on corporate actions, access to research analysts and company visits and access to IPOs.
129. On or about the end of December 2005, Paul Reeder, a principal of PAR requested a \$7 million line of credit from UBS for PAR Capital Management, Ed Shapiro and Reeder himself ("PAR Insiders").
130. The purported purpose of the loan, from the PAR Insiders' perspectives, was to pay certain personal liabilities. In particular, Shapiro requested the loan because assets of his were tied up in a PAR hedge fund that was illiquid due to restricted stock positions.
131. On January 3, 2006, Richard DelBello wrote to Sanjeev Karkhanis: (*See Exhibit H.*)
- As I think you know, PAR is one of the premier accounts that came via the ABN deal. They are a very low maintenance, sole PB account. We need to figure out away to satisfy these requests quickly and efficiently, within the bank... I know, your group are supposed to focus, solely on Hedge Funds, but the reality is that these larger funds that are sole PBd with us, often need some customized services, like this. **We need to accommodate them or risk losing them to competitors** like Citi, who will do this, easily and quickly. How would you suggest we proceed? (*emphasis added*)
132. Alex Ehrlich, Global Head of Prime Services responded to the above e-mail saying, "I agree with Dick, and am wholly supportive."
133. On March 14, 2006, Karkhanis, wrote to Ehrlich, DelBello, Neil Spencer and Brian Straus saying that "...Chris Ryan wanted to engage in a new business which would involve lending to hedge fund managers (as opposed to hedge funds which is your business)." Among the reasons for the rejection of Ryan's proposal by Karkhanis, David Bawden and Lisa Feld was: (*See Exhibit I.*)

We question whether it is necessary to provide such high-risk financing in order to more successfully pitch for flow business from the funds. We have a

significant trading and PB presence within the hedge fund industry without having provided such financing in the past. **There is the potential for conflict of interest issues** in situations where we have exposures to the funds themselves and to the IMs; while it may be in our best interests as creditors of a fund to close out our trades with that fund, this may be contrary to our interests as a creditor at the IM level. *(emphasis added)*

134. The UBS Wealth Management business group rejected the line of credit to the PAR Insiders.

135. According to Karkhanis in an e-mail sent on March 24, 2006: *(See Exhibit J)*

Why did WM [Wealth Management] refuse the loan to Principles. I don't buy into the explanation that they wanted PB account as collateral. WM in ordinary course of business lends money against hedge fund collateral. Is there a contact for me to speak to. If UBS wants to deliver to our client as one firm, then why we cannot do this loan in WM. **As you know, from a governance perspective, the loans to individuals should be booked in WM.** *(emphasis added)*

136. In the same e-mail, Karkhanis suggested that the loan "can only be approved as an exception." In part, this was because:

We have generally adopted a principal in Equities Division which is we don't give loans/write options to Principles where we write structured products to our clients or where we are the PB and the collateral is the funds they manage. *(emphasis added)*

137. In response to the above e-mail, Neil Spencer wrote, among other things, **"this mail chain should not be forwarded due to its sensitive nature."** *(emphasis added)*

138. UBS was willing to use information attained in its role as Prime Broker to the hedge fund to monitor and protect its loans extended for with the Hedge Fund Adviser and its principals.

139. Although the PAR hedge fund was not a counterparty in the provision of loans to the PAR Principals, UBS pointed to its ability to monitor the PAR hedge funds as a way to reduce the risk of the loans.

140. According to an e-mail by Torrasi, **"I don't believe this is such a risk because we are the sole prime broker and can monitor the activity in the fund."** (*emphasis added*) See Exhibit K.
141. According to the official internal UBS credit request, "[t]he advantage of this approach is that UBS has the right to call back the proceeds on any given day, thus there is no term, or lock-up in this instance. We are also sole prime broker to this company and thus have complete transparency and control over their portfolio."
142. Even though a Prime Broker may be permitted to view a hedge fund's holdings for purposes related to the hedge fund, it is inconsistent with the UBS Code of Business Conduct and Ethics for the Prime Broker to use its knowledge of a hedge fund's holdings for other purposes.
143. According to the UBS Code of Business Conduct and Ethics, "[w]e do not use inside information for any purposes other than those for which this information has been originally given to us."
144. The loans to the PAR Insiders, an "out-of-policy" transaction, was permitted within the bank as a way to appease a hedge fund manager whose fund generated substantial revenue to UBS as the sole Prime Broker.
145. According to an e-mail from Neil Spencer, "upon speaking with Paul Reeder he accepted that this was not an easy proposal for UBS to move forward with, and this would strictly be an accommodation for a top tier client with whom we have a very strong 15-year relationship." See Exhibit J.
146. According to the e-mail from Neil Spencer, the loan proposal was "underwritten by Prime Services, and the Equity Business Heads, on the basis that are making an

accommodation in the amount of a aggregate \$5 million facility to a client with whom we have a 15-year relationship as sole Prime Broker, and from whom we expect to make approximately [redacted] in revenues annually.”

147. Many senior UBS managers, including the Chairman and of the UBS Investment Bank approved the loans to the PAR Insiders.

148. On April 6, 2006, Vijay Sundaram, Global Head of Risk for Prime Services, e-mailed Claire Painter:

Hi Claire:

Here is the note describing the loan request from Par Investments. As I mentioned, Daniel already chatted with Alex about this, last Friday, and was comfortable – but there was a requirement for Huw’s approval (either from Daniel or David Bawden – not sure here). Pls could you ask Huw and Daniel whether Daniel’s approval is sufficient? Many thx for your help.

149. The note describing the loan request from PAR included the following conditions for the credit line to the PAR Insiders: (See Exhibit L)

5. Risk Mitigants

Since we cannot depend on the hedge fund collateral, this is effectively a \$5mm naked loan to a client that paid us [redacted] last year. Since we are sole PB to the funds, we can establish triggers to mitigate our risk:

(a) Net Equity triggers on the hedge fund:

- If Equity declines by >20% from its starting value, the loans will be terminated.
- If there is a peak-to-trough drawdown in Equity of 40% at any time, the loans will be terminated

(b) UBS ceases to be sole PB, then we get to terminate loans.

6. Overall Assessment

This is not something we would do in the ordinary course of business and there are risks that differ from those in our regular PB business. However, we are considering it as a defensive measure to protect our existing position with Par based on:

- The fund’s long-standing and exclusive relationship with UBS-PB;
- [redacted] revenue stream from Par;
- Relatively small size of the loan request (\$5mm).

150. The terms of the credit line extended to the PAR Insiders would allow UBS to call the loan for any reason.
151. Based on internal UBS communications, UBS would call the loan to the PAR Insiders if the amount of revenue UBS generated from PAR substantially dropped or if PAR entered into relationships with other prime brokers.
152. On March 24, 2006, Sanjeev Karkhanis wrote in an e-mail: (See Exhibit J)
- What is the pricing on these loans. There is a clear market for Individuals for borrowing money against hedge fund collateral. Are we giving these loans at PB rate? Although this loan is not similar in purpose to the NBI proposed by Chris Ryan, if I recollect correctly, the pricing there was 6% spread (I could be wrong).
153. Ultimately, the personal loans were provided to the PAR Insiders at a spread of 40 basis points over the Federal Funds Rate.
154. The borrowing rate mentioned in the March 24, 2006 Karkhanis e-mail is 5.6% higher than the rate actually provided.
155. On information and belief, the rate provided to the PAR Insiders was the same rate that the PAR hedge funds paid to borrow from UBS, not the rate individuals in the same situation as the PAR Insiders would receive if the loans were provided at arms-length.
156. The PAR loans from Torrisi's perspective was "more of a relation builder, not a revenue generator."
157. On April 11, 2006, Torrisi e-mailed the Chief Legal Officer for PAR Capital Management with a modified prime brokerage agreement intended to govern the loan to the PAR Insiders.

158. On April 11, 2006, the Chief Legal Officer for PAR Capital Management responded to Torrissi with questions about whether the prime brokerage agreement could or should be used to govern a line of credit.
159. On April 13, 2006, PAR Capital Management sent signed execution pages for the loan to the PAR Insiders to UBS.
160. On information and belief, the execution pages for the loan were sent by PAR to UBS prior to the loan documentation or contracts being finalized.
161. On information and belief, the loan to PAR Insiders was not approved by all necessary UBS personnel prior to the loan being extended to the UBS Insiders.
162. On April 6, 2006, Alex Ehrlich wrote: (*See Exhibit L*)
- It was David Bawden who said that Huw needed to agree. David said that he and Huw had the authority to approve 'small loans like this' on their say-so, **in cases such as this where the loan amount was small relative to either acquiring or protecting a related larger revenue stream. David felt this loan fit that criteria, and said he supported it, but that Huw also needed to agree.** (*emphasis added*)
163. On or about April 18, 2006, UBS delivered \$2.8 million to an account controlled by Shapiro as a revolving line of credit.
164. On June 30, 2006, David Bawden sent an e-mail to Huw Jenkins stating:

In April I was requested to approve a \$5 mio "out-of-policy" loan to PAR Capital Management (Investment Manager of PAR Investment Partners) and/or two of its four principals. Purpose of facility is to cover mis-matches between [redacted] or [redacted] and the cash flow generated by management fees (management co) and/or redemption proceeds (principals). Management fees are running at approx., [redacted]. The facility is secured by a pledge of the management company's equity interest in the G.P., a lien on the management fees and a pledge of the individuals' interests in the hedge fund. **We are PAR Investment Partners sole prime broker and earned approx. [redacted] on the account in 2005. In view of the importance of the relationship, I have approved. Your approval is also needed under the provisions of the "out-of-policy" limit. Can you please confirm your approval by return e-mail. Thanks.** (*emphasis added*)

165. On June 30, 2006, Huw Jenkins, the Chairman and Chief Executive Officer of UBS Investment Bank, approved the credit line extended to the PAR Insiders, writing:
- I would not like us to make a habit of this and that should be communicated to PB.**
(emphasis added) See Exhibit M.
166. On or about July 3, 2006, Shapiro journaled \$2,831,686.26 to UBS in repayment of his loan.
167. At some time between December 7, 2006 and January 4, 2007 UBS provided a loan to Paul Reeder in the amount of \$850,000.
168. On February 9, 2007, the Enforcement Section discussed with Paul Reeder at length about various products and services UBS provided to PAR Capital Management. Mr. Reeder declined to mention the loan provided to Paul Reeder, Ed Shapiro or PAR Capital Management.
169. When asked on February 9, 2007 whether the Enforcement Section left anything out of the discussion of products and services provided by UBS to the Hedge Fund Adviser, Paul Reeder answered, under oath, "Nothing else that I can think of offhand."
170. Paul Reeder's statement was barely more than a month after he repaid a personal loan from UBS.
171. PAR has never disclosed the credit line or the potential for harm stemming from the credit line to its investors.
172. Ed Shapiro executed a Federal Reserve Form T-4 indicating that UBS would extend a \$2.8 million line of credit for Paul Reeder.

173. Paul Reeder executed a Federal Reserve Form T-4 indicating that UBS would extend an \$850,000 line of credit for Paul Reeder. The collateral for the line of credit was \$850,000 "mv of underlying securities" in "Partnership interest in PAR Investment Partners, L.P."
174. PAR Capital Management executed a Federal Reserve Form T-4 indicating that UBS would extend a \$3 million line of credit for PAR Capital Management. The collateral for the line of credit was \$3 million "mv of underlying securities" in "Partnership interest in PAR Investment Partners, L.P."

viii. Capital Introduction

175. Capital Introduction is a division within UBS Prime Brokerage.
176. The Capital Introduction group includes approximately 15 full time employees.
177. The role of UBS Capital Introduction is to introduce UBS's Hedge Fund Advisers to potential hedge fund investors, with the intention that the investors may be interested in investing with the Hedge Fund Advisers.
178. An increase in the total assets managed by a Hedge Fund Adviser would result in a higher Management Fee to the Hedge Fund Adviser.
179. Although UBS Capital Introduction does not itself generate any fees, according to Eisen:

It's justified in three ways, I think: **Number one would be that you have to have it in order to win mandates because everybody else on the street has it,** every other prime broker has capital introduction and so if you don't have it you're not going to win or keep specialist mandates...; Number two is that you have clients that exist and you have to play defense and they would leave you if you didn't have it, so you need it to keep them; and number three is that although there is not a direct revenue source that comes from it, I think you can -- a reasonable person would expect that a large hedge fund is a more valuable economic -- economically more valuable client than a small client and so to the extent we are doing things that may lead to or support or in some way help our clients to grow, then we're probably making our client base more economically valuable to us. *(emphasis added)*

180. Although UBS's Capital Introduction group is the ultimate arbiter of the quantity of Capital Introduction provided to a given Hedge Fund Manager, according to Eisen:

[t]he sales team will give us some guidance with respect to the, you know, the size of the client, the profitability of the client, the, you know, the overall value of the client either from a qualitative or a quantitative perspective and what they would hope we would be willing and able to do in terms of resource allocation and then we make our determination.

181. UBS provides Capital Introduction to Hedge Fund Advisers free of charge.

ix. Meals, Drinks and Tickets to Sporting and Entertainment Events.

182. UBS provides the Hedge Fund Advisers to prospective and existing Prime Brokerage clients with gifts, gratuities and business entertainment.

183. Those gifts, gratuities and business entertainment are provided, at least in part, to induce Hedge Fund Advisers to place the business of the funds they manage with UBS.

184. Hedge Fund Advisers are principals, agents or representatives of the hedge funds they manage.

185. The employees and principals of Hedge Fund Advisers are persons, principals, proprietors, employees, agents or representatives of the Hedge Fund Advisers and the hedge funds they manage.

a. Feingold O'Keeffe

186. On or about August 1, 2004, Feingold O'Keeffe became a Prime Brokerage client of UBS.

187. Between December 20, 2003, and the time that Feingold O'Keeffe became a Prime Brokerage client of UBS, Michael Torrisi paid a total of \$994.52 on behalf of employees of Feingold O'Keeffe for meals, drinks and sports tickets.

188. During the approximately two month period from December 24, 2003 until February 26, 2004, Torrasi, on six occasions, bought Ian O'Keeffe a total of \$259.86 worth of meals, drinks and/or sporting events.
189. During the approximately two month period from December 24, 2003 until February 26, 2004, Torrasi, on six occasions, bought another Feingold O'Keeffe employee a total of \$259.86 worth of meals, drinks and/or sporting events.
190. Between December 20, 2003, and the time that Feingold O'Keeffe became a Prime Brokerage client of UBS, Torrasi paid \$563.37 on behalf of Ian O'Keeffe for meals, drinks and sports tickets.
191. On January 3, 2007, Ian O'Keeffe was asked by the Division, "So aside from the real estate licensing and the prime brokerage relationship that you described, the provision of tech support and the pizza lunches that you described, is there anything of value or any other aspect of the relationship with UBS that exists other than what I just described?"
192. O'Keeffe answered, "That's a pretty open-ended question. But, my answer would be no."

b. Tickets to Sporting and Entertainment Events as Gifts

193. On or about August 10, 2004, Torrasi purchased two tickets to a Boston Red Sox baseball game valued at \$165.00 each for a total of \$330.00. According to Torrasi's reporting of this event, he provided those tickets to two employees of PAR and he did not attend the event.
194. On or about September 20, 2004, Torrasi purchased one ticket to a Boston Red Sox baseball game valued at \$300.00. According to Torrasi's reporting of this event, he provided that ticket to one employee of PAR and he did not attend the event.

c. Other Gifts and Expenses

195. Between February, 2005 and present, UBS personnel bought at least 15 gifts for Hedge Fund Advisers in connection with the birth of babies. At least 5 of these gifts were valued at more than \$100.00.
196. Torrasi charged \$12,000 for "Red Sox Suite Tickets" to his corporate credit card on March 12, 2006. Christopher Hagstrom approved all of these charges.
197. On May 2, 2006, when the Red Sox played the New York Yankees at Fenway Park in Boston, Massachusetts, Torrasi charged a total of \$1,331.08, or \$147.90 per attendee, of food to his corporate credit card. Included on his list of attendees at the event were representatives from PAR, Delta and an employee of another Adviser Resident. Christopher Hagstrom, a Co-Head of Global Equity Finance approved all of these charges.
198. On June 19, 2006, Torrasi charged a total of \$1,732.56, or \$346.41 per attendee, to his corporate credit card, listing the business purpose as "Food for suite @ Sox game." Included on his list of attendees at the event were the principals from Delta Advisors LLC. Christopher Hagstrom approved all of these charges.
199. Principals of PAR, Feingold O'Keeffe and other Resident Hedge Fund Advisers were also allowed to attend UBS Employee Holiday Dinners and functions.
200. Employees and Principals of Feingold O'Keeffe, Delta and PAR were among the attendees at a "COO/CFO dinner" that totaled \$4,498.52, and was charged to Torrasi's corporate credit card in March of 2006. Christopher Hagstrom approved these charges.
201. According to records provided by UBS, Torrasi was denied approval of items claimed in his travel and expense reports on only two occasions between December of 2006 and March of 2007.

C. Non-Compliance with Books and Records Obligations

202. UBS does not comply with its obligations under NASD Rules to supervise its provision of gifts, gratuities and inducements and does not maintain documentation of such required by such rules.
203. While UBS has produced documents to the Division evidencing that it has put policies and procedures in place to monitor compliance with Rule 3060, UBS has not produced any documents evidencing that it has implemented or monitors such policy.
204. UBS admitted, through its attorneys, that it does not maintain a separate record of all payments or gratuities known to it.
205. Specifically, in response to a request for documents dated June 1, 2007 requesting "all documents prepared pursuant to NASD Rule 3060 relating to Mike Torrisi's client-related expenses" from January 1, 2005 to the present, UBS's attorney stated, in a letter to the Division dated June 7, 2007, "Although UBS maintains records of gifts as required by NASD Rule 3060(c), there are no records that are specifically designated as being prepared solely for that purpose."
206. Subsequently, the Division requested documents evidencing compliance with the supervisory and recordkeeping requirements of NASD Rule 3060(c). The Division did not receive the documents requested or reasonable assurances that they would be provided in a timely manner, and subsequently subpoenaed those documents. The subpoena requested, among other things:
5. All Documents evidencing UBS's review for compliance with NASD Rule 3060 of gifts, gratuities, travel or entertainment provided by UBS to Licensees during the Relevant Timeframe. The Documents specified in this paragraph 5 include, without limitation, all documents evidencing any assessment by UBS whether its provision of gifts, gratuities, travel and/or entertainment to Licensees during the Relevant Timeframe

(a) is consistent with regulatory requirements, (b) creates the potential for conflicts of interest or (c) is otherwise not in conformity with UBS's policies and procedures with respect to gifts, gratuities, travel or entertainment.

207. The language of the subpoena mirrored the requirement of the NASD Report on Examination Findings Regarding Gifts and Gratuities released on December 4, 2006, which stated, in relevant part:

This review revealed that many firms have not instituted reasonably designed systems and procedures to achieve compliance with the gift rule. firms are not consistently identifying all recipients of gifts and entertainment and assessing in the ordinary course of business whether such activities (a) are consistent with regulatory requirements, (b) create the potential for conflicts of interest or (c) are otherwise not in conformity with the firms' own policies and procedures with respect to gifts, gratuities, travel or entertainment.

While the observations and findings described herein have not, to date, been reflected in formal disciplinary actions, the issues presented maybe the subject of future disciplinary actions. . . .

208. In response to the Division's subpoena, UBS produced no documents evidencing any assessment by UBS whether its provision of gifts, gratuities, travel and/or entertainment to Resident Advisers during the Relevant Timeframe (a) is consistent with regulatory requirements, (b) creates the potential for conflicts of interest or (c) is otherwise not in conformity with UBS's policies and procedures with respect to gifts, gratuities, travel or entertainment.
209. UBS did not provide documents to demonstrate an aggregation of gifts or entertainment per recipient.
210. UBS did not provide reports that indicate that UBS differentiates between gifts and entertainment in its record-keeping system.
211. The reports UBS did provide indicate a lack of adequate safeguards to prevent violations of Rule 3060 and indicate the inadequacy of the firm's supervisory system.

212. The reports UBS did provide indicate violations of its own Group Policy on Gifts, Compliance bulletins issued in 2003, 2004 and 2005, and the "Gift, Gratuities and Entertainment Guidelines" section of the "General Supervisory Procedures" manual reissued in March of 2007.
213. UBS does not undertake any meaningful supervision to ensure that it or its agents or employees do not violate NASD Rule 3060.
214. UBS does not assess on a regular basis whether the gifts and gratuities provided to Resident Advisers, other Hedge Fund Advisers and the individual principals of Resident Advisers and other Hedge Fund Advisers, all as described above, (i) are consistent with regulatory requirements, (ii) create the potential for conflicts of interest, or (iii) are otherwise not in conformity with firms' own policies and procedures."

D. Failure to Abide by the Terms of the Undertakings

215. The Undertakings required ABN Amro and now UBS to ensure that Massachusetts registered investment advisers provided written disclosure to their clients if the advisers had both prime brokerage agreements with ABN Amro as well as licensed office space from ABN Amro.
216. The Resident Advisers of UBS office space include the Capital Defense Funds ("CDF"). CDF is a state registered investment adviser that manages separate accounts on behalf of its clients.
217. CDF is the only Massachusetts registered investment adviser that licenses office space from UBS.
218. CDF or the separate accounts are Prime Brokerage clients of UBS and license office space from UBS.

219. Because CDF is not a hedge fund, but manages separate accounts for its clients, it files an investment adviser registration and disclosure document ("Form ADV"). CDF's Form ADV does not contain the disclosure required by the Undertakings.
220. On information and belief, CDF does not provide written disclosures required by the Undertakings nor written disclosures that disclose the type of information covered by the Undertakings.

VI. CONCLUSIONS OF LAW

Violations of § 204

221. Paragraphs 1 through 220 are incorporated herein
222. Section 204 of the Act states in relevant part:
- (a) The secretary may by order impose an administrative fine or censure or deny, suspend, or revoke any registration or take any other appropriate action if he finds (1) that the order is in the public interest and (2) that the applicant or registrant or, in the case of a broker-dealer or investment adviser, any partner, officer, or director, any person occupying a similar status or performing similar functions, or any person directly or indirectly controlling the broker-dealer or investment adviser:-- (G) has engaged in any unethical or dishonest conduct or practices in the securities, commodities or insurance business;... (J) has failed reasonably to supervise agents, investment adviser representatives or other employees to assure compliance with this chapter;
223. Section 12.204 of Title 950 the Regulations states:
- (1) Dishonest and unethical practices in the securities business.
- (b) Broker-dealers. Each broker-dealer shall observe high standards of commercial honor and just and equitable principles of trade in the conduct of its business. Acts and practices, including, but not limited to, the following, are considered contrary to such standards and constitute dishonest or unethical practices which are grounds for imposition of an administrative fine, censure, denial, suspension or revocation of a registration, or such other additional action:...
- 28. Failing to comply with any applicable provision of the NASD Rules of Fair Practice or any applicable fair practice or ethical standard promulgated by the SEC or by a self-regulatory organization approved by the SEC. (*emphasis added*)**

Violation of Memorandum of Understanding

224. By failing to adhere to the provisions of the Memorandum of Understanding, UBS engaged in dishonest and unethical practices in violation of §204(a)(2)(G) of the Act.

Gift and Gratuities Violations

225. NASD Rule 3060, Influencing or Rewarding Employees of Others, reads in relevant part:

(a) No member or person associated with a member shall, directly or indirectly, give or permit to be given anything of value, including gratuities, in excess of one hundred dollars per individual per year to any person, principal, proprietor, employee, agent or representative of another person where such payment or gratuity is in relation to the business of the employer of the recipient of the payment or gratuity. A gift of any kind is considered a gratuity...

(c) A separate record of all payments or gratuities in any amount known to the member, the employment agreement referred to in paragraph (b) and any employment compensation paid as a result thereof shall be retained by the member for the period specified by SEC Rule 17a-4.

226. UBS's "General Supervisory Procedures U.S. Equities" and multiple "Compliance Bulletins" state in relevant part:

Gifts to clients in recognition of births, illnesses or funerals may be provided but are covered by the \$100 per-person, per year gift limits, and must be pre-approved by the Line Manager. If an employee has a personal relationship with a client, any other personal gifts that the employee may give to them... may not be expensed, and should be consistent in value with gifts they customarily give to personal friends, to avoid the appearance of impropriety.

227. The NASD has interpreted Rule 3060 to apply to providing a recipient with a financial arrangement that is guaranteed to make money for the recipient, such as an arrangement where the recipient was given the opportunity to participate in the upside of hot Initial Public Offerings.

228. By analogy, the provision of free office space and loans at below market rates are gifts or gratuities.

229. By providing office space to multiple Hedge Fund Advisers, each with discounts valued at more than \$1,000.00 below what it paid, UBS violated NASD Rule 3060 and therefore engaged in dishonest and unethical practices in violation of §204(a)(2)(G) of the Act.
230. By providing the value of discounts on office space to Hedge Fund Advisers and their owners with values greater than \$100.00, UBS violated NASD Rule 3060 and therefore engaged in dishonest and unethical practices in violation of §204(a)(2)(G) of the Act.
231. By providing millions of dollars of loans to a Hedge Fund Adviser, priced well below market rates, and valued at more than \$100.00, UBS violated NASD Rule 3060 and therefore engaged in dishonest and unethical practices in violation of §204(a)(2)(G) of the Act.
232. By providing millions of dollars of loans to the principals of a Hedge Fund Adviser, priced well below market rates, and valued at more than \$100.00, UBS violated NASD Rule 3060 and therefore engaged in dishonest and unethical practices in violation of §204(a)(2)(G) of the Act.
233. By providing gifts to clients valued at more than \$100.00, UBS violated NASD Rule 3060 and therefore engaged in dishonest and unethical practices in violation of §204(a)(2)(G) of the Act.
234. By providing tickets to sporting events or entertainment events to clients valued at more than \$100.00, even though no UBS employee accompanied those clients to the events, UBS violated NASD Rule 3060 and therefore engaged in dishonest and unethical practices in violation of §204(a)(2)(G) of the Act.

Books and Records Violations

235. In addition to violating the gift and gratuity-giving requirements of 3060(a) as described above, UBS has violated the recordkeeping requirements of NASD Rule 3060(c).

236. Section 203 of the Act, Post-Registration Provisions, states in relevant part:

(a) Every registered broker-dealer and investment adviser shall make and keep such accounts, correspondence, memoranda, papers, books and other records as the secretary by rule prescribes. All records so required shall be preserved for three years unless the secretary by rule prescribes otherwise for particular types of records.

237. Title 950 of the Regulations, Section 12.203: Post Registration Requirements, states in relevant part:

(2) Record Keeping Requirements. Each broker-dealer shall maintain the following records:... (c) All records required to be maintained by any SRO or national exchange of which the broker-dealer is a member.

238. In its Notice to Members 06-69 (December 2006), the NASD provided the following guidance with regard to supervision and recordkeeping:

Rule 3060 requires separate recordkeeping of gifts and gratuities. Rule 3010 requires a firm to have a supervisory system reasonably designed to achieve compliance with Rule 3060. In order to meet these standards, firms are required to have systems and procedures reasonably designed to ensure that gifts in relation to the business of the employer of the recipient given by the firm and its associated persons to employees of clients of the firm are (i) reported to the firm, (ii) reviewed for compliance with Rule 3060, including aggregation as discussed above, and (iii) maintained in the firm's records. . . .

239. The report indicated that to comply with NASD Rule 3060, documentation must be easily accessible and maintained by the firm in a centralized manner.

240. By failing to maintain a separate record of all payments or gratuities it provides to persons, principals, proprietors, employees, agents and representatives of another clients in accordance with NASD Rule 3060, UBS violated NASD Rule 3060 and therefore engaged in dishonest and unethical practices in violation of §204(a)(2)(G) of the Act.

241. By failing to provide documents demonstrating an aggregation of gifts or entertainment by recipient, UBS violated NASD Rule 3060 and therefore engaged in dishonest and unethical practices in violation of §204(a)(2)(G) of the Act.
242. By failing to provide reports that indicate UBS differentiates between gifts and entertainment in its record keeping system, UBS violated NASD Rule 3060 and therefore engaged in dishonest and unethical practices in violation of §204(a)(2)(G) of the Act.
243. By failing to maintain the records required by NASD Rule 3060 and thus by Title 950 of the Regulations, Section 12.203(2)(c), UBS violated §203 of the Act.

Failure to Supervise

244. NASD Rule 3010, Supervision, reads in relevant part:
- (a) supervisory system: Each member shall establish and maintain a system to supervise the activities of each registered representative, registered principal, and other associated person that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable NASD Rules. Final responsibility for proper supervision shall rest with the member...
245. By failing to assess whether gifts and gratuities provided by its registered agents to Hedge Fund Advisers and the individual principals of Hedge Fund Advisers (i) are consistent with regulatory requirements, (ii) create the potential for conflicts of interest, or (iii) are otherwise not in conformity with firms' own policies and procedures, UBS has failed to properly supervise its agents and therefore violated §204(a)(2)(J) of the Act.
246. By failing to assess whether gifts and gratuities provided by its registered agents to Resident Advisers and the individual principals of Resident Advisers (i) are consistent with regulatory requirements, (ii) create the potential for conflicts of interest, or (iii) are otherwise not in conformity with the firms' own policies and procedures, UBS violated

NASD Rule 3010 and therefore commit dishonest and unethical acts in violation of §204(a)(2)(G) of the Act.

247. By failing to police its Code of Business Conduct and Ethics, UBS has failed to properly supervise its agents and therefore violated §204(a)(2)(J) of the Act.
248. By failing to police its Code of Business Conduct and Ethics, UBS has failed to properly supervise its agents and therefore violated NASD Rule 3010 and therefore engaged in dishonest and unethical practices in violation of §204(a)(2)(G) of the Act.
249. By failing to police its own policies and procedures relating to gifts and gratuities, UBS has failed to properly supervise its agents. Accordingly, UBS violated NASD Rule 3010, and therefore engaged in dishonest and unethical practices in violation of §204(a)(2)(G) of the Act.
250. By failing to police its own policies and procedures relating to gifts and gratuities, UBS has failed to properly supervise its agents and therefore violated §204(a)(2)(J) of the Act.
251. Because UBS did not establish, maintain or enforce a supervisory system reasonably designed to achieve compliance with NASD Rule 3060, UBS violated NASD Rule 3010, and therefore engaged in dishonest and unethical practices in violation of §204(a)(2)(G) of the Act.
252. Because UBS did not establish, maintain or enforce a supervisory system reasonably designed to achieve compliance with NASD Rule 3060, UBS has failed to properly supervise its agents and therefore violated §204(a)(2)(J) of the Act.

VII. PUBLIC INTEREST

253. For any and all of the reasons set forth above, it is in the public interest and will protect Massachusetts investors to issue an Order of the Division: 1) requiring Respondent to

permanently cease and desist from violating the Act and Regulations; 2) censuring Respondent; 3) requiring Respondent to pay an administrative fine in an amount and upon such terms as the Director or Hearing Officer may determine; and 4) taking such further action as may be deemed just and appropriate by the Director or Hearing Officer for the protection of investors.

VIII. STATUTORY BASIS FOR RELIEF

254. Section 407A(a) of the Act states:

If the secretary determines, after notice and an opportunity for hearing, that any person has engaged in or is about to engage in any act or practice constituting a violation of any provision of this chapter or any rule or order issued there under, he may order such person to cease and desist from such unlawful act or practice and may take such affirmative action, including the imposition of an administrative fine, the issuance of an order for an accounting, disgorgement, or rescission or any other such relief as in his judgment may be necessary to carry out the purposes of [the Act].

X. RELIEF REQUESTED

255. Wherefore, the Enforcement Section of the Division requests that the Director or Hearing Officer take the following action: find as fact the allegations set forth in paragraphs 1 to 220 of the Complaint and issue an Order of the Division: 1) requiring Respondent to permanently cease and desist from violating the Act and Regulations; 2) censuring Respondent; 3) requiring Respondent to pay an administrative fine in an amount and upon such terms as the Director or Hearing Officer may determine; and 4) taking such further action as may be deemed just and appropriate by the Director or Hearing Officer for the protection of investors.

ENFORCEMENT SECTION
MASSACHUSETTS SECURITIES DIVISION

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