STATE OF ALASKA
DEPARTMENT OF COMMERCE, COMMUNITY, AND ECONOMIC DEVELOPMENT
DIVISION OF BANKING AND SECURITIES
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STATE OF ALASKA
DEPARTMENT OF COMMERCE, COMMUNITY, AND ECONOMIC DEVELOPMENT
DIVISION OF BANKING AND SECURITIES

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| IN THE MATTER OF:<br><br>UBS SECURITIES, LLC AND<br>UBS FINANCIAL SERVICES INC.,<br><br>Respondents. | ADMINISTRATIVE CONSENT ORDER<br><br>ORDER NO: 10-10-S |

WHEREAS, UBS Securities LLC and UBS Financial Services Inc. (collectively “UBS”) are broker-dealers registered with the State of Alaska; and

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

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

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

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

WHEREAS, UBS elects to permanently waive any right to a hearing and appeal under the Alaska Securities Act, Alaska Statutes (“AS”) 45.55, and the Administrative Procedures Act, AS 44.62, with respect to this Administrative Consent Order (the “Order”).

NOW, THEREFORE, the State of Alaska, Department of Commerce, Community, and Economic Development, Division of Banking and Securities (the “Division”), as administrator of

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the Alaska Securities Act, hereby enters this Order:

## I. JURISDICTION AND AUTHORITY

1. UBS admits the jurisdiction of the Division, neither admits nor denies the Findings of Fact and Conclusions of Law contained in this Order, and consents to the entry of this Order by the Division.

## II. RESPONDENTS

2. UBS Securities LLC ("UBS Securities") is a broker-dealer registered with the State of Alaska, with a Central Registration Depository ("CRD") number of 7654.

3. UBS Financial Services Inc. ("UBS Financial Services") is a broker-dealer registered with the State of Alaska, with a CRD number of 8174.

## III. FACTS AND ALLEGATIONS

A. How UBS Marketed and Sold Its ARS to Its Clients

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

4. UBS customers in Alaska were sold ARS and, in most instances, were told they were safe, liquid money-market instruments.

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

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

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

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

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

*(2.) UBS Brokers Who Sold ARS to Clients Understood them to be Safe, Liquid Cash Alternatives or Money-Market Instruments*

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

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

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

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

13. In testimony provided to the task force, the Director of Product Management for UBS Financial Services ("Director of Product Management") indicated a wide range of information that FAs should know prior to selling ARS to customers, including the issuer's

identity, the type of ARS, the credit quality, how the auction process works, and that a customer bid may or may not get filled for that auction.

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

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

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

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

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

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

18. Through January 2008, the client statements issued to retail customers listed ARS

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under the heading: "Cash Alternatives/Money Market Instruments."

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

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

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

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

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

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

B. <u>UBS's ARS Program Was Inconsistent With How It Was Promoted to Clients and Financial Advisors</u>

*(1.) Background on Mechanics of ARS*

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a. Dutch Auction Process

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

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

b. Types of Auction Rate Securities

(i.) Auction Preferred Shares ("APS")

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

(ii.) Municipal Auction Rate Certificates

26. Municipal auction rate certificates ("Municipal ARCS") are debt instruments (typically municipal bonds) issued by governmental entities with a long-term nominal maturity and a floating interest rate that is intended to be reset through a Dutch auction process. They receive

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long-term ratings from the major rating agencies and are often backed by monoline insurance.

(iii.) Student Loan-Backed Auction Rate Certificates

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

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

*(2.) UBS's ARS Program*

a. Underwriting

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

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

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

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

b. Broker-Dealer Agreements

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

34. UBS Securities often served as lead manager, but sometimes served as co-manager

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of auctions with other large broker-dealers.

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

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

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

c. Distribution of ARS by UBS Financial Services

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

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

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

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

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

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

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

44. On all of the auctions for which it was the sole or lead broker-dealer, UBS

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Securities placed support bids to ensure that the auctions would not fail.

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

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

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

e. UBS's Setting of Interest Rates

*(i.) Price Talk*

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

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

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

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

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

52. In contrast to the understanding that retail investors were given that the interests rates on these securities were actually set through the auction process, the Head of Short-Term

Trading said, "We are making pricing decisions based on our ability to attract investors while managing issuer client relationships and will continue to do so in efforts to move securities."

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

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

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

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

*(4.) UBS's Inventory of ARS Increased Substantially From August 2007 Through Mid-February 2008*

a. Inventory Increased Beyond Cap Imposed by Risk Management

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

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

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

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

b. Pushback from Risk Management

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

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

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

a. Enhanced Marketing Efforts for ARS

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

*(6.) After August 2007, UBS's Concerns Regarding ARS Intensified Causing UBS to Debate Its Ongoing Role in the Auction Markets*

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

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

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balance sheet reduction.

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

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

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

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

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

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

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

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

85. UBS's auction rate program, in which it actively managed to influence the interest

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rates on ARS (which interest rates, in theory, should have been set by auctions), put it in a fundamentally conflicted role.

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

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

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

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

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

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

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

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

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

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

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

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

95. On February 13, 2008, without prior notice to its customers who had purchased ARS, UBS failed its auctions for ARS.

## IV. <u>CONCLUSIONS OF LAW</u>

1. The Division has jurisdiction over this matter pursuant to the Alaska Securities Act.

2. UBS Failed to Supervise. As described in the Findings of Fact above, UBS has failed reasonably to supervise its agents. As a result, UBS violated AS 45.55.060(b)(1).

3. UBS Engaged in Dishonest and Unethical Practices. As described in the Findings of Fact above, UBS has engaged in dishonest or unethical practices or conduct in the securities or investment business. As a result, UBS violated AS 45.55.060(a)(7).

4. The Division finds the following relief appropriate and in the public interest.

## V. <u>ORDER</u>

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

IT IS HEREBY ORDERED:

1. This Order concludes the investigation by the Division and, except as provided in

Paragraph V.19, precludes any other action that the Division could commence under applicable Alaska law on behalf of Alaska as it relates to UBS's marketing and sale of ARS.

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

3. UBS shall cease and desist from violating the Alaska Securities Act and will comply with the Alaska Securities Act.

4. Within ten days after the date of this Order, UBS shall pay the sum of Seven Hundred Thirty-Three Thousand Four Hundred Sixty-Five Dollars and Sixty-One Cents ($733,465.61) to the State of Alaska, such amount to be restricted to the following specific use by the Division: promoting investor education, investor protection, and compliance with the securities laws.

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

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

7. <u>Eligible Customers</u>. As used in this Consent, an "Eligible Customer" is any current or former UBS customer (not including (i) broker-dealers or (ii) banks acting as conduits for their customers) who opts in to the relief provided pursuant to this Order and meets any of the following criteria:

a. Held the Eligible ARS at UBS as of February 13, 2008 or in DVP accounts as of February 13, 2008 for which UBS had bidding rights; or

b. Purchased Eligible ARS at UBS between October 1, 2007 and February 12, 2008, and transferred those ARS out of UBS prior to February 13, 2008;

8. <u>Offer periods</u>.

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a. First Offer Period.

(i) No later than October 31, 2008, UBS shall have offered to purchase at par Eligible ARS from all Eligible Customers who:

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

(b) Are either:

i. Individual customers, or

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

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

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

(ii) This First Offer Period will remain open until January 4, 2011.

b. Second Offer Period.

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

a. Individual customers,

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

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

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

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

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

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

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

9. Customer Notification and Opt In Procedures.

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

b. Second Notice and Opt In. To the extent that any Eligible Customer did not opt in during the Initial Opt In Period, UBS shall have provided any such customer a second written notice describing the relevant terms of this Order as related to Eligible Customers within seven (7) business days of the expiration of the Initial

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Opt In Period. Customers will have had thirty (30) days after the mailing date of the second written notice to notify UBS that they opt in to the relief described in the ARS Settlement Notice. This Order does not require UBS to purchase the ARS of any customer that was mailed the ARS Settlement Notice but did not opt in to the relief described in the ARS Settlement Notice. Any customer who did not opt in to the relief provided pursuant to this Order may pursue any other remedies against UBS available under the law.

c. Customer Assistance Line and Internet Page. Within five (5) business days of the entry of this Order, UBS shall have updated: (i) its dedicated toll-free telephone ARS assistance line, with appropriate staffing, to provide information and to respond to questions concerning the terms of this Order; and (ii) the public Internet page regarding ARS on UBS's corporate Web site(s), with a prominent link to that page appearing on UBS's relevant homepage(s), to provide information concerning the terms of this Order and, via an e-mail address or other reasonable means, to respond to questions concerning the terms of this Order. UBS shall maintain the telephone assistance line and Internet page through June 30, 2010 or the completion of UBS's obligation pursuant to Paragraph V.15 of this Order, whichever is later.

10. Purchase Procedures.

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

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

(ii) Discretionary Sales on Behalf of Customers. Starting on the business day following the date that an Eligible Customer opted in to the relief described in the ARS Settlement Notice, UBS shall be authorized to exercise discretion on such customer's behalf to effect sales or other dispositions of Eligible ARS, including but not limited to secondary sales. UBS shall make customers whole at par (plus any accrued and unpaid dividend/interest) if any such disposition occurs below par. Any such discretion shall be exercised by UBS solely for the purpose of facilitating restructurings, dispositions, or other par solutions for customers. UBS represents that the purpose of this aforementioned discretion is to permit UBS to mitigate potential damages while still returning par to customers. In addition, starting the business day following the date on which an Eligible Customer opted in to the relief described in the ARS Settlement Notice, UBS shall be authorized to exercise reasonable discretion to purchase at par Eligible ARS that are tax-exempt Auction Preferred Stock issued by closed-end funds.

(iii) Written Notice of Expiration. Thirty (30) days before the expiration of each relevant timeframe set forth in Paragraph V.8, UBS shall provide written notice to those customers eligible under Paragraph V.8 who have not sold their Eligible ARS to UBS. This written notice shall notify the customers about the impending expiration of the relevant timeframe,

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describe the state of the ARS market at that time, and explain the consequences of failing to sell their ARS to UBS prior to the expiration of the relevant timeframe.

b. Returning ARS to UBS Custody. Because the Eligible ARS must be in UBS custody prior to UBS being able to purchase such ARS, the customer must return the Eligible ARS to UBS's custody before placing an order to sell the Eligible ARS to UBS. To this end, UBS shall use its best efforts to assist customers eligible for relief under this Order who have transferred ARS out of UBS custody in returning Eligible ARS to UBS custody and shall not charge such customers any fees relating to or in connection with the return to UBS or custodianship by UBS of such Eligible ARS.

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

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

13. Refund of Refinancing Fees to Municipal Issuers. By June 30, 2009, UBS shall have refunded to municipal issuers underwriting fees each issuer paid to UBS for the refinancing or conversion of ARS that occurred after February 13, 2008, where UBS acted as underwriter for

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both the primary offering of ARS between August 1, 2007 and February 12, 2008, and the refunding or conversion of the ARS after February 13, 2008.

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

15. Purchase from Certain Additional Customers.

a. Subject to the limitations described in Paragraphs V.15.d.and V.15.e, with respect to former UBS customers who are either individuals; charities, endowments, or foundations with Internal Revenue Code Section 501(c)(3) status; or small businesses (entities with less than $10 million in assets with UBS other than institutional customers who have represented they have total assets of greater than $50 million, or otherwise are determined to have assets greater than $50 million, as of August 8, 2008), and who purchased Eligible ARS at UBS on or after January 1, 2000 and transferred the Eligible ARS from UBS before February 13, 2008 and continue to own the Eligible ARS, UBS shall offer to purchase the customer's Eligible ARS at par plus any accrued and unpaid dividends/interest, provided such customer has contacted or contacts UBS to request that UBS purchase the Eligible ARS.

b. Within thirty (30) days of March 4, 2010, UBS shall offer to purchase Eligible ARS from each customer eligible under Paragraph V.15.a who is recorded as having contacted UBS before March 4, 2010.

c. For each customer eligible under Paragraph V.15.a who contacts UBS after



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March 4, 2010, within thirty (30) days of UBS receipt of the customer's request, UBS shall offer to purchase Eligible ARS from such customer.

d. The Eligible ARS must be in UBS custody prior to UBS being able to purchase such ARS under this section. Former customers who are eligible under this section must return the Eligible ARS to their prior UBS account or, in the case of former accounts that have been purged, to new UBS accounts opened by the customer. UBS shall not charge such customers any fees relating to or in connection with the return to UBS of such Eligible ARS

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

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

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

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

17. Reports and Meetings.

a. Reports. Within thirty (30) days after March 4, 2010, and then quarterly after that, UBS shall submit a written report detailing UBS's progress with respect its obligations under paragraph V.15. This report shall be submitted to a representative specified by the North American Securities Administrators Association ("NASAA").

b. The reporting obligation set forth above may be amended with written permission from a designated NASAA representative.

18. Special Arbitration Process.

a. UBS shall consent to participate, at the customer's election, in the special arbitration procedures described below. Under these procedures, an arbitration process, under the auspices of the Financial Industry Regulatory Authority ("FINRA"), will be available for the exclusive purpose of arbitrating consequential damages claims by individual (non-institutional) Eligible Customers who meet the criteria under paragraphs V.8.a and V.8.b. above.

b. Applicable procedures.

(i) Arbitrator. The special arbitrations will be conducted by a single public arbitrator.

(ii) Forum and Filing Fees. UBS shall pay all forum and filing fees with respect to customer claims eligible for the special process.

(iii) Proof. Eligible Customers will bear the burden of proving by a preponderance of the evidence, the existence and amount of

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consequential damages suffered as a result of the illiquidity of the Eligible ARS. Although UBS will be able to defend itself against such claims, UBS shall not argue against liability for the illiquidity of the underlying ARS position. Furthermore, UBS will not use as part of its defense the customer's decision not to borrow money from UBS prior to September 15, 2008.

(iv) Other Damages. Eligible Customers who elect to use the special arbitration procedures provided for in this Order shall not be eligible for punitive damages, or any other type of special damages other than consequential damages.

(v) Applicability of FINRA Procedures. The special arbitrations shall be subject to the rules and procedures adopted by FINRA for such arbitrations to the extent such rules and procedures are not inconsistent with the NASAA Special Arbitration Procedures provision relating to Relief Available, or the terms and provisions specified herein.

19. Ability to Take Additional Actions. The Division will discontinue all investigations of the marketing and sale of ARS by UBS, and will withdraw and/or not commence any enforcement or other proceeding against UBS in connection with its marketing and sale of ARS. Notwithstanding this paragraph, the Division may investigate specific sales practice complaints involving ARS. In connection with such investigations, the Division may not seek remedies against the firm or its agents such as penalties, fines, license suspension or revocation, disgorgement, or cease and desist or injunctive relief for any conduct related to UBS's marketing and sales of ARS, as such conduct is set forth in this Order.

20. UBS AG. In consideration of the Division entering into this settlement as reflected

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in this Order, UBS AG will satisfy the financial obligations to customers herein on behalf of UBS Financial Services, Inc. and UBS Securities LLC.

## VI. ADDITIONAL CONSIDERATIONS

1. If payment is not made by UBS, or if UBS defaults in any of its obligations set forth in this Order, the Division may vacate this Order, at its sole discretion and without opportunity for administrative hearing, after providing UBS notice and an opportunity to cure the default(s) within ten (10) days after the date of the notice.

2. This Order is not intended to indicate that UBS or any of its affiliates or current or former employees shall be subject to any disqualifications contained in the federal securities law, the rules and regulations there under, the rules and regulations of self-regulatory organizations or various states' securities laws including any disqualifications from relying upon the registration exemptions or safe harbor provisions. In addition, this Order is not intended to form the basis for any such disqualifications.

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

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

5. This Order and any dispute related thereto shall be construed and enforced in accordance with, and governed by, the laws of the State of Alaska without regard to any choice of

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law principles.

6. UBS, through its execution of this Consent Order, voluntarily waives its right to a hearing on this matter and to judicial review of this Consent Order under the Alaska Securities Act and the Administrative Procedures Act.

7. UBS enters into this Consent Order voluntarily and represents that no threats, offers, promises, or inducements of any kind have been made by the Division or any member, officer, employee, agent, or representative of the Division to induce UBS to enter into this Consent Order.

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

SO ORDERED this 14th day of December, 2010.

State of Alaska
Department of Commerce, Community, and Economic Development
Division of Banking and Securities

/s/ Lorie L. Hovanec
By: Lorie L. Hovanec, Director

## CONSENT TO ENTRY OF ADMINISTRATIVE ORDER BY UBS SECURITIES LLC AND UBS FINANCIAL SERVICES INC.

UBS Securities LLC ("UBS Securities") and UBS Financial Services Inc. ("UBS Financial")(collectively "Respondents"), hereby acknowledge that they have been served with a copy of this Administrative Order, have read the foregoing Order, are aware of their right to a hearing and appeal in this matter, and have waived the same.

Respondents admit the jurisdiction of the Division, neither admit nor deny the Findings of Fact and Conclusions of Law contained in this Order, and consent to entry of this Order by the Division as settlement of the issues contained in this Order.

Respondents agree that they shall not claim, assert, or apply for a tax deduction or tax credit with regard to any state, federal, or local tax for any administrative monetary payment that Respondents shall make pursuant to this Order.

Respondents state that no promise of any kind or nature whatsoever was made to them to induce them to enter into this Order and that they have entered into this Order voluntarily.

Mark Shelton and Abby Meiselman represent that they are Managing Directors of UBS Securities, and that, as such, have been authorized by UBS Securities to enter into this Order for and on behalf of UBS Securities.

Jonathan Eisenberg represents that he is General Counsel of UBS Financial Services and that, as such, has been authorized by UBS Financial Services to enter into this Order for and on behalf of UBS.

Thomas C. Naratil represents that he is Managing Director of UBS Financial Services and that, as such, has been authorized by UBS Financial Services to enter into this Order for an on behalf of UBS Financial Services.

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Dated this 2nd day of December, 2010.

UBS Securities LLC

/s/ Mark Shelton
By: Mark Shelton

Title: Member of the Board of Managers
UBS Securities LLC

State of Connecticut )
) ss.
County of Fairfield )

SUBSCRIBED AND SWORN TO before me this 2nd day of December, 2010.

/s/ Cynthia A. Stevens
Notary Public

My commission expires:

10/31/2012

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UBS Securities LLC

/s/ Abby Meiselman
By: Abby Meiselman

Title: Head of Litigation & Investigations
UBS Securities LLC

State of New York )
) ss.
County of Manhattan )

SUBSCRIBED AND SWORN TO before me this 2nd day of December, 2010.

/s/ Carol Ellis
Notary Public

My commission expires:

October 28, 2014

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UBS Financial Services Inc.

/s/ Jonathan Eisenberg
By: Jonathan Eisenberg

Title: General Counsel
UBS Financial Services Inc

State of New Jersey )
) ss.
County of Hudson )

SUBSCRIBED AND SWORN TO before me this 6th day of December, 2010.

/s/ Bernadette C. Pehrson
Notary Public

My commission expires:

02/17/2014

UBS Financial Services Inc.

/s/ Thomas C, Naratil
By: Thomas C. Naratil

Title: Managing Director
UBS Financial Services Inc.

State of New Jersey )
) ss.
County of Hudson )

SUBSCRIBED AND SWORN TO before me this 6th day of December, 2010.

/s/ Bernadette C. Pehrson
Notary Public

My commission expires:

02/17/2014

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