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Autorità federale di vigilanza sui mercati finanziari FINMA
Swiss Financial Market Supervisory Authority FINMA

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SUMMARY REPORT

FINMA Investigation into the Events surrounding Trading Losses of USD 2.3 billion incurred by the Investment Banking Division of UBS AG in London

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I. Summary

(1) On 15 September 2011 UBS AG ("UBS" or the "Bank") announced that it had discovered a significant loss due to unauthorised trading by a trader in its Investment Bank. This loss, which was calculated to be approximately USD 2.3 billion (the "Loss"), was incurred on the Exchange-Traded Funds Desk ("Desk" or "ETF Desk") within the Investment Bank's London Branch and was primarily the result of trading by one of the traders on the Desk ("Trader X"). FINMA's investigation into this incident has found serious failings in UBS's risk management and control environment. These failings contributed to UBS's inability, over an extended period of time, to detect or prevent the loss-making trading activity. Immediately following the discovery of the Loss, FINMA imposed a range of preventive supervisory measures, designed to limit the operational risk exposure of UBS. Furthermore, FINMA subsequently ordered enforcement measures controlling UBS's remediation actions.

II. Background

(2) Following the announcement of the Loss, UBS was required by FINMA and the UK Financial Services Authority ("FSA") to appoint a third party to conduct (i) an independent investigation into the events surrounding the Loss, and (ii) a wider examination of the adequacy of UBS's systems and controls to prevent unauthorised trading across the Investment Bank. The choice of the third party investigator and the scope of its investigation was determined by FINMA and the FSA. The investigation is now closed.

(3) On 2 February 2012 FINMA announced that it had commenced enforcement proceedings against UBS to examine the adequacy of UBS's controls and its compliance with relevant Swiss laws and regulations. At the same time, the FSA announced that it had commenced enforcement proceedings against UBS for suspected breaches of UK regulatory requirements. The enforcement proceedings of FINMA and the FSA were separate, but closely co-ordinated.

(4) On 20 November 2012 Trader X was found guilty on charges of fraud by abuse of position and not guilty on charges of false accounting in London's Southwark Crown Court.

(5) This report sets out the facts and findings of FINMA's enforcement proceedings against UBS in relation to the circumstances surrounding the Loss incurred within the London Branch of UBS's Investment Bank.

III. Facts

A. UBS's organisation

(6) UBS's Investment Bank comprises a number of business divisions, including the Global Equities division. The divisions are sub-divided into a number of specific business sectors. The ETF Desk was located within the Global Equities division, where historically it formed part of the Cash Equities business sector and was supervised by a senior, London-based Cash Equities trader. In April 2011, the ETF Desk was transferred to a new business sector, Global Synthetic Equities ("GSE"). GSE had been formed in early 2011, when UBS restructured its existing Global Equities business sectors to combine the trading and sale of synthetic equity products into a new business sector. This transfer was accompanied by a change in supervisor. The Desk's new supervisor within GSE was based in New York. While plans for him to relocate to London later in 2011 were underway, no arrangements for local supervision of the Desk in the interim period were put in place. There was no concrete handover of responsibilities between the Desk's old and new supervisors.

(7) During the period investigated by FINMA, there were four traders on the ETF Desk. The Desk's mandate permitted client and proprietary trading in certain cash equity products.[1] Trading for the bank's own account ("proprietary trading") was chiefly undertaken by the two most senior traders (both Directors, one of whom was Trader X), who also undertook client trading. The two junior traders (both Associate Directors) mainly undertook client trading. The Desk was subject to net delta limits, which represented the maximum level of risk that the Desk could enter into at any given time unless specifically authorised to do otherwise. The intended intraday net delta limit was USD 50 million, while the overnight net delta limit was USD 25 million. These limits were increased in April 2011 when the Desk moved to GSE, to USD 100 million and USD 50 million respectively. The Desk's trading mandate and risk limits were not formally documented at Desk level, but were instead communicated to the traders verbally.[2]

(8) Proprietary trading was expected to generate the majority of the ETF Desk's revenues. This contrasted with the position in the overall Global Equities division, where revenues were predominantly driven by commissions from client trading. Proprietary trading revenues on the Desk increased sharply from 2010 (when they stood at USD 11.7 million for the entire year), reaching USD 15.9 million in Q1 2011 and USD 47.8 million in Q2 2011. These increases, which were attributed to intraday trading, were not analysed in detail.

(9) The Back Office functions that supported and controlled the ETF Desk included, amongst others, Operations, Product Control (part of Finance) and Market Risk.

[1] The Desk's mandate permitted trading in the following products: ordinaries (vanilla cash equities), including those forming part of a basket or index; American Depositary Receipts; Global Depositary Receipts; ETFs; investment trusts; and (as hedges) exchange-traded options and futures and spot foreign exchange.

[2] The Desk's intraday net delta limit was documented in a June 2011 email from the Desk's supervisor; however, this email was not sent to all the traders on the Desk.

9.1. Operations' key relevant areas of responsibility in respect of the Desk were the reconciliation process and trade confirmation and settlement.

9.1.1. The reconciliation process involved ensuring that items recorded in different systems reconciled with each other. Any reconciliation failures (known as reconciliation 'breaks') were required to be investigated by Operations to ensure their resolution, although there was no requirement to effectively analyse the causes of breaks or the manner in which breaks were eventually resolved.

9.1.2. Operations was also responsible for ensuring the timely confirmation of trades with deferred settlement terms. Such trades were identified on a specific report maintained by an outsourcing provider based in India (the "T+14 report").

9.2. Product Control was responsible for the validation and reporting of profit and loss ("P&L") and the verification and substantiation of balance sheet items.

9.2.1. P&L reports were prepared by Product Control on a T+1 basis and circulated within the Front Office, Product Control and Risk. In addition to the Product Control T+1 report, the ETF Desk itself produced a T+0 P&L estimate for distribution to the Desk's supervisor and Product Control. The T+1 report and the T+0 estimate showed the net end of day P&L only; they did not show P&L at trade level or attributed by sub-product, as UBS's Product Control systems did not have the capability to show this level of data for the products traded by the Desk.

9.2.2. Balance sheet verification and substantiation took place at month end, through the Global Balance Sheet Ownership and Verification ("GBSOV") process. Any unverifiable balance sheet items in excess of CHF 10 million were required to be escalated to senior Finance management for review.

9.3. Market Risk was responsible for measuring and controlling all market risks taken by business areas. Market Risk focused on end of day risk reporting and analysis. It did not have a mandate to formally monitor and control desk level risk limits, as this was the responsibility of the Front Office. The market risk system in place in respect of the ETF Desk did not support automated monitoring of the Desk's positions against their risk limits.

(10) The support and control infrastructure underlying the ETF Desk was not fully realigned when the Desk was moved out of Cash Equities. In particular, Product Control responsibilities continued to be exercised by a Cash Equities team for several months (and had not been transferred to the GSE Product Control team by the time that the Loss was discovered).

B. Activity that led to the Loss

(11) The Loss was incurred on large exchange-traded index futures positions that were initiated by Trader X. These positions were in fact unhedged. Approximately USD 2.1 billion of the Loss arose from long EURO STOXX 50 and S&P 500 futures positions that peaked at a size of USD 12.1 billion

on 8 August 2011 and were closed out by 11 August 2011. The remainder of the Loss was incurred on short S&P 500 and DAX futures positions that were entered into after 11 August 2011 (following close out of the long exposure). The short exposure peaked at USD 8.5 billion on 15 September 2011, when UBS closed out the positions following the discovery of Trader X's activities.

(12) Trader X used a number of mechanisms to disguise the Desk's true risk exposures. These mechanisms generated fictitious P&L and risk exposure, thereby offsetting and concealing the Desk's true P&L and risk. This enabled Trader X to take positions that were grossly in excess of the Desk's net delta limits, while appearing (on P&L and risk reports) to remain within those limits. Concealment mechanisms were in use from late 2008. From late 2008 to the end of 2010, the use of concealment mechanisms generated fictitious risk exposures of up to USD 296 million and fictitious P&L in excess of USD 40 million. The scale of the activity increased significantly in 2011.

(13) The main concealment mechanisms used were as follows:

13.1. One-sided internal futures trades: these trades were not matched against an internal counterparty, did not require confirmation and were subject to less stringent control processes. The trades were fictitious and generated fictitious risk exposure and P&L.

13.2. Late booking of genuine external futures trades into the Front Office risk system: the effect of delaying the booking of these trades was to misreport the Desk's risk exposure and P&L.

13.3. Fictitious ETF trades with deferred settlement dates: these trades, which were cancelled before reaching settlement, generated fictitious risk exposure and P&L. Deferred settlement trades should have been identified on the T+14 report. However, this report was non-operational between May and November 2009, and from November 2010 to September 2011 (shortly before discovery of the Loss). The following variants of these trades were also used:

13.3.1. Fictitious ETF trades at off-market prices: the off-market pricing of these trades generated significant immediate ('day 1') P&L.

13.3.2. Amendments to the prices of fictitious ETF trades: the pricing amendments had the effect of further misreporting the Desk's P&L.

13.4. Zero-notional bullet cash trades: these were fictitious trades with a quantity and price of zero and an added cash flow (usually used to book cash-settled events such as dividends). The cash flows were used to clear reconciliation breaks generated by the use of other concealment mechanisms.

(14) Trader X also developed a profit smoothing mechanism which came to be known on the Desk as the 'umbrella' from January 2011. The umbrella involved the use of a number of concealment mechanisms in use throughout the period from late 2008 (particularly zero-notional bullet cash trades) to hold back profits from the Desk's reported P&L and to later 'leak' profits back into the P&L. It was employed to smooth the Desk's reported P&L over time. The mechanism was in breach of UBS poli-

cy, which required P&L to be reported when earned. Other traders on the Desk were aware of the umbrella; none of them escalated any concerns to senior management.

(15) In December 2010, an incident took place that resulted in Trader X being disciplined by the Desk's supervisor. On this occasion, Trader X failed to follow an instruction to flatten the Desk's risk exposure, yet informed the supervisor that he had complied with the direction. The disciplinary measure taken was a verbal warning. The incident was not escalated beyond the Desk's immediate supervisor.

(16) The ETF Desk's supervisor and his line manager (who was the head of GSE) were made aware of breaches of the Desk's net delta limits on at least four occasions between June and July 2011. On one such occasion, when the Desk had made a large profit of USD 6 million, it was made clear by Trader X that this had been achieved by taking intraday positions in excess of USD 200 million (i.e. more than twice the Desk's intraday net delta limit). The supervisor initially congratulated the Desk on this performance, before reminding them that his authorisation was required if they wished to exceed the Desk's risk limits. This was the extent of the response to the breach of risk limits. On three other occasions, daily risk reports circulated to the Desk's supervisor (and his line manager) indicating that breaches of the Desk's overnight net delta limit had occurred. No apparent action was taken in response.

(17) The monitoring of cancelled, amended and late booked ("C/A/L") trades is a key element in the detection of suspicious trading activity. Within UBS's London Branch, Front Office supervisors monitored C/A/L trades using an online system, the Supervisory Control Portal ("SCP"). This system generated daily reports (known as 'alerts') of C/A/L trades, which were sent to Front Office supervisors for investigation and sign-off. Futures trades did not, however, generate SCP alerts due to the lack of a data feed from the relevant Front Office system to SCP, a failing that was not remedied until 26 August 2011. UBS did not have any formal policy covering the allocation and delegation of SCP C/A/L trade alerts among supervisors. One consequence of this was that when the ETF Desk was transferred to GSE, there was a failure to redirect SCP C/A/L trade alerts to the Desk's new supervisor. The alerts continued to be sent to, and signed off by, the Desk's previous supervisor, even though he was no longer supervising the Desk. A second consequence was that when SCP alerts for C/A/L futures trades went live in August 2011, the alerts for the Desk were sent to traders on the Desk (including Trader X) for sign-off, rather than to their supervisor.

(18) UBS also lacked a clear policy describing Front Office supervisors' responsibilities in respect of reviewing and signing off SCP C/A/L alerts. Confusion about these responsibilities meant that alerts for the ETF Desk were not properly reviewed. Consequently, C/A/L alerts for fictitious, deferred settlement ETF trades each generating material P&L (in excess of USD 0.5 billion) were signed off in August 2011 without any investigation.

(19) Traders were able to influence their reported P&L to compensate for trade booking errors, trade capturing timing differences and delayed pricing . This was done by making a request to Product Control. UBS had no formal policy governing the P&L adjustment process, and Product Controllers were not required to obtain supervisory approval before adjusting P&L. At the request of Trader X, material adjustments were made to the ETF Desk's reported P&L on numerous occasions, particu-

larly in August 2011. One set of adjustments, on 11 August 2011, was for approximately USD 1 billion: this offset a USD 1 billion loss that appeared in the Desk's P&L that day. The Desk's Product Controllers processed these adjustments without challenge and without informing their supervisors. As the T+1 reports produced by Product Control showed the P&L after any adjustments had been applied, these adjustments were not visible to the Desk's supervisor in the Front Office. By 18 August 2011, Product Control supervisors were aware that a number of material adjustments had been made to the ETF Desk's P&L. They were not concerned at this, believing the adjustments were connected to material reconciliation break issues that were being dealt with by Product Control and Operations at that time (described in paragraph (21)). They did, however, subsequently tighten the P&L adjustment process, requiring details of any adjustments to be made visible in the T+1 P&L reports prepared by Product Control.

(20) Within UBS's London Branch, it was well known amongst junior Operations staff that the ETF Desk (particularly Trader X) created a lot of reconciliation breaks, often due to late or mis-booked trades. This issue was not raised with the Desk's supervisor or with senior Operations management. From June 2011, the breaks became material in size: many were connected to trades with huge notional values (sometimes in excess of USD 1 billion). In investigating these breaks, Operations usually liaised with Trader X. Operations staff tended to take the explanations given by him at face value, even where material breaks persisted for several weeks, without effective escalation to their supervisors.

(21) On 2 August 2011, a material ETF Desk-related break was identified by Finance during the July month end GBSOV process (the "GBSOV break"). This break was valued at CHF 209 million, which represented the net difference between two control accounts; however, the gross open risk position associated with the break amounted to EUR 4 billion. The GBSOV break was the result of large futures trades that had not been booked in the Front Office risk system. Product Control and Operations repeatedly contacted Trader X about the break and were told that the missing futures trades would be booked shortly, clearing the break. Although this did not happen, and the break persisted for some time, Product Control and Operations continued to accept the explanations given by Trader X. They did not escalate the break to the ETF Desk's supervisor for more than two weeks after its initial identification. With input from Trader X, Product Control prepared a detailed explanation of the reasons for the GBSOV break. Despite lacking credibility in many respects, the explanation was not challenged by any of the Front Office, Operations or Product Control staff who saw it and was accepted by those present at a senior Finance committee meeting on 24 August 2011. The conclusion of this meeting was that no amounts were at risk.

(22) Queries about the ETF Desk's trades continued to be raised by Operations in late August and early September 2011. By 13 September 2011, senior Finance managers had begun asking questions about credit risk issues relating to deferred settlement ETF trades booked by Trader X. The next day, in response to this line of questioning, Trader X effectively admitted that the ETF trades in question were not real trades and had been booked to hide losses incurred on genuine "off book" (meaning unauthorised) positions. UBS began an investigation and closed out Trader X's positions in the following days. The total Loss resulting from these trades was calculated to be approximately USD 2.3 billion.

IV. Findings

(i) Mismanaged transfer of the ETF Desk

(23) The process around the ETF Desk's transfer from Cash Equities to GSE was not adequately managed. This jeopardised the supervision and effective functioning of the business. A smooth transfer of the Desk would have required a well-planned and transparent handover of supervisory responsibilities between the old and new supervisors.

(24) The ETF Desk's support and control infrastructure was not realigned at the same time as the Desk's transfer to GSE. The delay in transferring Product Control responsibilities for the Desk caused difficulties for the Cash Equities Product Control team. This team had understood that it would continue to exercise Product Control responsibilities for the Desk for only a short time after the transfer and did not, therefore, invest the necessary time to remain familiar with the Desk's activities. By failing to appropriately adapt the support and control infrastructure at the time of the Desk's transfer, UBS prioritised risk taking at the expense of support and control. In so doing, UBS contributed to the failure of the Cash Equities Product Control team to analyse the significant increases in the Desk's proprietary trading revenue.

(25) Upon the transfer of the ETF Desk to GSE, the previous Cash Equities supervisor ceased to have any supervisory responsibilities over the Desk. Being based in New York, the Desk's new GSE supervisor was unable to supervise the Desk effectively on a day-to-day basis. A local, London-based supervisor was needed to bridge the gap, but no such arrangement was put in place. The outcome was a lack of oversight of the Desk's day-to-day activities. This is incompatible with the Bank's duty to have in place an adequate organisational structure with clearly defined and understood responsibilities and reporting lines.

(ii) Poor supervision

(26) Relationships between supervisors and the traders on the Desk were characterised by too much trust and not enough discipline and control. For example, significant increases in the Desk's proprietary trading revenue were not questioned by senior Front Office managers. The Desk's explanation, that the increases were due to intraday trading, was not analysed or verified.

(27) Risk limit breaches were brought to the attention of the Desk's supervisor and his line manager on at least four occasions, but no investigation was carried out, nor was any disciplinary action taken. On one such occasion, the supervisor's first reaction was to offer congratulations, before later giving a reminder of the Desk's intraday net delta limit. The lack of an appropriate response to such incidents demonstrates that excessive risk taking and breaches of risk limits were not actively discouraged or penalised.

(28) The Desk's supervisor travelled to London in August 2011 to investigate the GBSOV break (described in paragraph (21)), but failed to conduct an adequate investigation. Instead, he relied upon assurances from Operations and Finance that the break had been resolved, without appreciating that

those assurances were based on information given by Trader X. The explanation for the break lacked credibility, but was not challenged by the Desk's supervisor.

(29) The Desk's supervisor was dropped from the circulation list for the Desk's T+0 P&L estimate in late July 2011 but did not question why he was no longer receiving this report, suggesting that he did not regularly review this information. In addition, he did not query the absence of reports on the Desk's C/A/L trades, suggesting that he did not consider such information to be a necessary supervisory tool.

(30) The level of supervision of the Desk failed to meet the standards prescribed in UBS's supervision policy. The failure to respond to policy and guideline violations encouraged non-compliance. The lack of discipline meant that Trader X was not deterred from breaching the Desk's risk limits, resulting in significant increases in the Desk's risk exposure and, eventually, a major loss to the Bank. The failure of the Desk's supervisors to exercise proper challenge and supervision hindered earlier detection of Trader X's activities and contributed to the Loss. By tolerating Trader X's repeated policy infringements and failing to appropriately challenge and supervise the Desk, UBS violated its obligations to conduct its business in a fit and proper manner and ensure an adequate organisation.

(iii) Ineffective control systems

(31) A number of failures undermined the effectiveness of the SCP control (described in paragraph (17)). In particular:

31.1. UBS failed to identify the absence of data on C/A/L futures trades in a timely manner. As a result, SCP C/A/L alerts for futures trades were not operational until late August 2011.

31.2. As the information available within SCP provided only limited trend analysis, the identification of suspicious trading patterns had to be performed manually. However, it was not generally feasible for Operations or Front Office desk supervisors to perform this task for high volume trading desks, such as the ETF Desk.

31.3. SCP roles and responsibilities were not clearly defined, leading to confusion about the SCP review process between Operations and the Front Office. This confusion was exacerbated by a lack of appropriate training. The inadequate review process performed by the Desk's previous supervisor, together with the new supervisor's failure to query the absence of alerts, illustrate that SCP's purpose as an important supervisory tool was not understood.

31.4. UBS failed to adequately control the mapping and delegation of SCP C/A/L alerts. This resulted in a failure to redirect alerts to the Desk's new supervisor, while alerts on futures trades (when they eventually went live) were sent to the traders on the ETF Desk, rather than to their supervisor.

(32) The purpose of the T+14 report was to identify deferred settlement trades, as these posed a greater risk to the Bank than trades settling within the usual T+3 cycle (see paragraph 9.1.2). The importance of this report was not understood. The report failed twice, for extended periods of time,

and the second failure of the report went unnoticed by UBS for approximately 10 months (see paragraph 13.3). Consequently, there was no working control in place to identify the large, deferred settlement trades booked by the ETF Desk.

(33) SCP and the T+14 report were key controls for the detection of suspicious trading activity, but both proved to be ineffective. The failures of these controls serve to illustrate poor organisation and risk management within UBS.

(iv) Insufficient understanding and challenge by Operations

(34) Trade reconciliation is a key element of a bank's internal controls. A proper understanding of trading activity is essential for successful reconciliation. A bank's management must ensure that trades are properly reconciled. Operations' poor understanding of the ETF Desk's trading activities meant that it was not in a position to identify the risks arising from the large, persistent reconciliation breaks caused by the Desk. Relevant Operations staff did not fully understand that the function of Operations was to exercise control over the Front Office, as well as to provide support.

(35) The explanation given by Trader X for the large reconciliation breaks caused by his use of concealment mechanisms was that they were the result of trade booking errors and that these would be corrected. Junior Operations staff did not adequately question what they were told; instead they continued to accept Trader X's explanations, even when the explanations were unsatisfactory (as in the case of the GBSOV break) or the breaks persisted for several weeks. A contributing factor to this lack of challenge was the tendency of Operations staff to view their role in terms of supporting and facilitating Front Office trading activity, rather than controlling it. Operations focused on clearing reconciliation breaks; insufficient emphasis was placed on understanding the causes of breaks, or how they were resolved.

(v) Inappropriate analysis and challenge by Product Control

(36) A bank's management must ensure that accounting entries are properly verified. This is achieved by having in place the appropriate staff and providing the infrastructure necessary to perform control tasks. Any failures by Product Control to analyse significant 'red flag' issues in this case can partly be attributed to a failure by UBS to provide Product Control with the tools necessary to properly perform its function, a failure that undermined Product Control's ability to detect Trader X's use of concealment mechanisms.

(37) Product Control accepted the Desk's explanation for the significant increases in the Desk's proprietary trading revenue without performing any satisfactory analysis. Product Control did not have the infrastructure necessary to review the Desk's P&L at trade level. The absence of a detailed, trade level P&L review meant that the significant P&L impact of the concealment mechanisms used by Trader X was not generally visible to Product Control. Furthermore, no satisfactory controls identified trades at off-market prices once they had been booked.

(38) Controls over P&L adjustments were inadequate (see paragraph (19)). UBS had no policy on escalating P&L adjustments: traders were not routinely required to evidence requests for adjustments,

Product Controllers did not challenge such requests, no escalation or approval thresholds were defined, and P&L adjustments were not visible to Front Office supervisors (in daily T+1 P&L reports) until 18 August 2011. The consequence of the lack of controls in this area was that material adjustments were made to the ETF Desk's P&L, concealing the significant losses incurred.

(39) The GBSOV process proved to be ineffective. The objective of GBSOV was to ensure that balance sheet balances were understood and fairly stated, and that unsubstantiated amounts were risk assessed, escalated and had the necessary remediation plans put in place. Even though the GBSOV break was escalated for review by a senior Finance committee, the GBSOV process failed to identify the significant amounts that were at risk (see paragraph (21)). Furthermore, Product Control's level of challenge to the Front Office was inadequate. In particular, Trader X's explanation for the GBSOV break was unsatisfactory in many respects, but was not challenged by Product Control.

(vi) Failure to identify and escalate risk issues

(40) Bank employees must inform their managers or Compliance departments of any events that represent a risk to the institution (FINMA Bulletin 1/2010, p. 51). To do this, employees must be made aware (by management) of their obligations and be able to recognise when escalation is appropriate. In this case there were a number of issues that, when considered together, could have alerted the support and control functions to the need for closer scrutiny of, and escalation of issues regarding, the ETF Desk. For example, Operations was aware of the Desk's persistent late and mis-booked trades, trades with huge notional values, and frequent and material reconciliation breaks. Product Control was aware of significant increases in the Desk's proprietary trading revenue, frequent and material adjustments to the Desk's P&L, and the issues surrounding the GBSOV break. These were not identified as significant risk issues and, consequently, were not appropriately escalated to senior Operations and Product Control management, or to the Desk's supervisors in the Front Office. Furthermore, in responding to these issues, neither function worked effectively with other support and control functions.

(vii) Ineffective Operational Risk Framework

(41) UBS's Operational Risk Framework relied heavily upon a process of self assessment by the Front Office and support and control functions.[3] Within this framework, UBS's Operational Risk department did not require evidence, or conduct substantive testing, to validate self assessment results. Self assessment was performed on an annual basis, which meant that it was possible for control deficiencies to go undetected for extended periods of time.

(42) In 2008, the Operational Risk unit reviewed the risk of a rogue trading event occurring within UBS. This review was carried out in response to the identification of rogue trading as a material fraud risk, following the Société Générale rogue trading incident earlier that year. The review identified a number of issues that are relevant to this case, including: in some areas, weaknesses in the challenge culture within the support and control functions (contributed to by significant staff turnover); weakness-

[3] A new, more robust Operational Risk Framework has since been implemented by UBS. The implementation process began in January 2011 (before the Loss was discovered) and was due to be completed in June 2012.

es in Front Office supervision relating to C/A/L trades; and concerns about the use of trades with deferred settlement dates. A follow up review in late 2010 reported that several actions had been taken since the 2008 review and that the issues described above had largely been addressed. These reviews, which were carried out in accordance with UBS's Operational Risk Framework, failed to ensure that identified control deficiencies were in fact sustainably remediated.

(viii) Ineffective policies and guidelines

(43) UBS failed to formalise and appropriately communicate the Desk's reporting lines and risk limits. Reporting lines were unclear, leading to confusion about whether one of the traders on the Desk had any supervisory responsibilities over his colleagues. Risk limits and trading mandates were not properly formalised and communicated to the Desk's traders, leaving the Bank unable to control compliance (see paragraph (7)).

(44) UBS had policies and processes in place to govern initiatives to create or change business lines. These included the Changes to Existing Business ("CEB") Policy, which was intended to ensure that proposed business changes were reviewed in conjunction with the relevant support and control functions and that the impact of the change was fully assessed and approved by those functions. The formation of GSE, and the subsequent transfer of the ETF Desk, involved changes to existing business lines, hence the CEB Policy should have been applied. While the support and control functions were involved in discussions about these changes, UBS did not formally apply the CEB Policy and the support and control functions did not give their formal approval. The failure by senior management to adhere to the Bank's own policies is indicative of a lack of focus on instilling a culture of compliance within the business.

(ix) Reward and recognition systems

(45) Despite several breaches of UBS's compliance policies relating to personal account dealing and spread betting, and despite a reputation for poor adherence to control standards, Trader X was highly remunerated and had been chosen to participate in a highly selective internal scheme for talented employees. This financial and non-financial recognition provided implicit incentives for risk-seeking behaviour.

(ix) Conclusion: inadequate control environment and business culture

(46) UBS failed to detect that trading activity had occurred outside the ETF Desk's risk limits and concealment mechanisms had been in use since late 2008. The failure to detect this activity for such a long period of time indicates widespread deficiencies across the Investment Bank's control environment. Despite efforts to improve the control framework, significant and sustained control deficiencies remained. This was not recognised or addressed by senior management.

(47) The focus of the Front Office was on generating profits. Front Office managers showed lenience to traders and had little interest in controlling their activities. Breaches of management instructions and risk limits were tolerated, not penalised, while significant increases in the Desk's proprietary

trading revenue were not examined. The emphasis on profits came at the expense of control and sound risk management.

(48) Senior management's emphasis on increasing efficiency compromised the effectiveness of certain controls. Support and control functions were under pressure to reduce staff numbers, and requests for additional headcount were denied. The transfer of the ETF Desk to GSE without the realignment of the support and control infrastructure shows that senior management did not consider these functions to be essential to sound business activity.

(49) Numerous 'red flags' relating to the ETF Desk were evident for some time, particularly since June 2011. These were not followed up appropriately. A stronger control framework may have enabled UBS to detect Trader X's activities at an earlier stage, reducing the eventual losses incurred.

(50) In conclusion, UBS's failure to control its trading and operational risks over an extended period of time resulted in a loss of approximately USD 2.3 billion. Accordingly, UBS failed to demonstrate fit and proper conduct.

V. Measures

(51) Immediately following the discovery of the Loss, FINMA imposed until further notice a range of preventive supervisory measures, designed to limit the operational risk exposure of UBS until able to give evidence that the operational control environment of its Investment Bank is working effectively:

a) Any new business initiative in the Investment Bank which is likely to materially increase the operational complexity of UBS needs FINMA's prior consent;

b) The Investment Bank's overall risk weighted assets are capped at specific and declining values for the years ending 2012-2015, in accordance with the bank's strategic plan;

c) The Investment Bank's risk weighted assets within its London Branch are also capped, with the cap declining over time;

d) UBS is forbidden from undertaking any acquisitions through its Investment Bank division.

(52) FINMA published, on 13 December 2011, its expectations for all Swiss banks and securities dealers relative to controls against unauthorised trading and required larger firms to assess themselves against these best practice standards, demanding follow-up action where necessary.

(53) Since the discovery of the Loss, UBS has taken a number of organisational measures aimed at strengthening its risk management and control capability (the "UTIR Programme"). Process improvements implemented across the UBS group include the documentation of key procedural controls and consistent handling and reporting for operational risk issues. UBS has also taken steps to instigate behavioural change by increasing the focus on risk control and supervision across the organisation. Within the Investment Bank, significant staffing changes have taken place, key appointments have been made to strengthen management, improvements have been made to core Front and Back

Office processes, and material weaknesses on long dated settlement trades and balance sheet substantiation have been remediated. Additional measures are under way.

(54) In concluding its enforcement proceedings on 21 November 2012, FINMA further reprimanded UBS for severe violation of its obligation to assure the fit and proper conduct of its business operations. FINMA also: *(i)* directed UBS to appoint an independent third party to report on the progress and completion of the Bank's UTIR Programme, *(ii)* required the appointment of a third party to ensure operational effectiveness of controls against unauthorised trading, subsequent to the implementation of remediating measures, *(iii)* announced that it will consider the appropriateness of the capitalisation of UBS's operational risks in the light of these and other failings.