

**UNITED STATES OF AMERICA**  
**Before the**  
**SECURITIES AND EXCHANGE COMMISSION**

**SECURITIES ACT OF 1933**  
**Release No. 9697 / January 15, 2015**

**SECURITIES EXCHANGE ACT OF 1934**  
**Release No. 74060 / January 15, 2015**

**ADMINISTRATIVE PROCEEDING**  
**File No. 3-16338**

<p><b>In the Matter of</b></p> <p style="text-align:center"><b>UBS SECURITIES LLC</b></p> <p><b>Respondent.</b></p>
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**ORDER INSTITUTING ADMINISTRATIVE  
AND CEASE-AND-DESIST PROCEEDINGS  
PURSUANT TO SECTION 8A OF THE  
SECURITIES ACT OF 1933 AND SECTIONS  
15(b) AND 21C OF THE SECURITIES  
EXCHANGE ACT OF 1934, MAKING  
FINDINGS, AND IMPOSING REMEDIAL  
SANCTIONS AND A CEASE-AND-DESIST  
ORDER**

**I.**

The Securities and Exchange Commission (“Commission”) deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 (“Securities Act”) and Sections 15(b) and 21C of the Securities Exchange Act of 1934 (“Exchange Act”) against UBS Securities LLC (“UBS”).

**II.**

In anticipation of the institution of these proceedings, UBS has submitted an Offer of Settlement (“Offer”) which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission’s jurisdiction over it and the subject matter of these proceedings, which are admitted, UBS consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933 and Sections 15(b) and 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order (“Order”), as set forth below.

### III.

On the basis of this Order and UBS's Offer, the Commission finds<sup>1</sup> that:

#### Summary

1. UBS is the owner and operator of UBS ATS, an alternative trading system ("ATS")<sup>2</sup> commonly referred to as a "dark pool." UBS ATS is a private execution venue that accepts, matches, and executes orders to buy and sell securities that it receives from UBS clients and UBS ATS subscribers. Those clients and subscribers include many of the world's largest asset managers, broker-dealers, and institutional investors, who may place trades on behalf of all kinds of investors, including pension funds and individuals with retail brokerage accounts. Between May 2008 and August 2012, UBS ATS was among the largest ATSs. As measured by dollar volume, it was the nation's largest equity ATS during the second quarter of 2014, having executed over \$416 billion in equity securities transactions in that period. During the same quarter, UBS executed trades for nearly 10.7 billion shares on UBS ATS.

2. Between 2008 and 2012, UBS's operation of and disclosures regarding UBS ATS violated federal securities laws and regulations at different times and in numerous ways.

3. Between May 2008 and March 2011, UBS violated Rule 612 of Regulation NMS promulgated under the Exchange Act by accepting and ranking hundreds of millions of orders priced in increments smaller than one cent ("sub-penny orders"). That rule was designed to prevent orders from executing before others based upon economically insignificant sub-penny differences in their prices. While many of the sub-penny orders

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<sup>1</sup> The findings herein are made pursuant to UBS's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

<sup>2</sup> Rule 300(a) of Regulation ATS promulgated under the Exchange Act provides that an ATS is "any organization, association, person, group of persons, or system: (1) [t]hat constitutes, maintains, or provides a market place or facilities for bringing together purchasers and sellers of securities or for otherwise performing with respect to securities the functions commonly performed by a stock exchange within the meaning of [Exchange Act Rule 3b-16]; and (2) [t]hat does not: (i) [s]et rules governing the conduct of subscribers other than the conduct of such subscribers' trading on such [ATS]; or (ii) [d]iscipline subscribers other than by exclusion from trading." Rule 301(a) of Regulation ATS provides that an ATS must comply with Rule 301(b) of Regulation ATS, unless the ATS is registered as a national securities exchange or qualifies for another enumerated exclusion. During the relevant period, UBS ATS was not registered as a national securities exchange and did not qualify for an enumerated exclusion. Therefore, it was required to comply with Regulation ATS, including Rule 301(b) thereunder, in order to benefit from the exemption from the definition of "exchange" provided by Rule 3a1-1(a)(2) under the Exchange Act.

accepted by UBS resulted from technical problems, many also were the product of two order types created for UBS ATS: PrimaryPegPlus (“PPP”) and Whole Penny Offset. Because they permitted a subscriber to enter an order that was priced in and ranked based upon an increment of less than one penny, those order types gave execution priority to subscribers who were willing to pay just a fraction of a penny more (or receive just a fraction of a penny less) for a share of stock than subscribers who had entered orders at lawful, whole-penny prices. In addition, because exchanges and ATSs that complied with Rule 612 of Regulation ATS rejected sub-penny priced orders submitted by their subscribers or did not provide those subscribers with access to functionalities that permitted them to enter sub-penny orders, those order types provided UBS ATS with an unfair competitive advantage over those trading venues.

4. During the period June 2010 through March 2011, UBS violated Section 17(a)(2) of the Securities Act by failing to disclose PPP to all UBS ATS subscribers. Although it was eventually disclosed to most subscribers, PPP was pitched almost exclusively to market makers and/or high-frequency trading (“HFT”) firms<sup>3</sup>, which UBS expected to be the primary users of the order type.

5. During the period March 2010 through July 2012, UBS violated Section 17(a)(2) of the Securities Act by failing to provide all UBS ATS subscribers with notice of a feature that could prevent an order from executing in the ATS against orders from subscribers whose flow was designated as “non-natural,” typically market makers and/or HFT firms. This feature – called the “natural-only crossing restriction” – was neither disclosed to nor made available to all UBS ATS subscribers. Instead, it could only be used to benefit orders generated on behalf of users of UBS’s trading algorithms or “algos,” *i.e.*, UBS clients that paid to have their trades executed systematically through a UBS trading tool that automated order placement, scheduling, and routing consistent with a specified strategy developed by UBS. Prior to July 2012, UBS had no internal policy or procedure requiring the disclosure of such features or new order types to all subscribers.

6. UBS violated Rule 301(b)(2) of Regulation ATS promulgated under the Exchange Act by (a) filing with the Commission and failing to amend a Form ATS<sup>4</sup> that included inconsistent and incomplete statements concerning UBS ATS’s acceptance of sub-penny orders, (b) failing to file, at least 20 days before it implemented the change, an amendment on Form ATS that disclosed a modification to the PPP order type; (c) failing to file, at least 20 days before it implemented the natural-only crossing restriction, an amendment on Form ATS that disclosed the existence of the natural-only crossing restriction and the fact that it was not available to all users of the ATS, and (d) failing to attach to the

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<sup>3</sup> A market maker is a firm that stands ready to buy and sell a particular stock on a regular and continuous basis at a publicly quoted price. All subscribers to the UBS ATS, including market makers and HFT firms, are registered broker-dealers.

<sup>4</sup> Filed with the Commission pursuant to Rule 301(b)(2) of Regulation ATS, a Form ATS is confidential document that an ATS uses to notify the Commission of its operations.

Form ATS a copy of UBS ATS's subscriber manual or other materials that were provided to UBS ATS subscribers.

7. During five months in 2011 and with respect to securities for which UBS ATS accounted for five percent or more of the average daily volume in four of the six preceding months as a result of a lapse in monitoring, UBS violated Rule 301(b)(5) of Regulation ATS by (a) failing to establish written standards for granting subscribers access to the natural-only crossing restriction, (b) unreasonably prohibiting subscribers from utilizing that crossing restriction, and (c) failing to disclose information about its grants, denials, and limitations of access in Forms ATS-R that it filed with the Commission.

8. Prior to August 2012, UBS violated Rule 301(b)(10) of Regulation ATS by failing to limit access to the confidential trading information of UBS ATS subscribers, including by granting access to the UBS ATS order book to 103 of its employees – primarily information technology (“IT”) personnel – who neither operated UBS ATS nor had responsibility for its compliance functions.

9. Prior to December 2010, UBS violated Section 17(a) of the Exchange Act, Exchange Act Rule 17a-4(b)(1), and Rules 301(b)(8) and 303 of Regulation ATS by failing to keep for prescribed periods and preserve certain order data for UBS ATS.

### **Respondent**

10. UBS is a Delaware entity with principal executive offices in New York, New York. It is a broker-dealer registered with the Commission. Since 2008, it has operated UBS ATS, which operates pursuant to Regulation ATS.

### **Facts**

#### **Sub-Penny Orders**

11. Rule 612 of Regulation NMS provides that “[n]o ... alternative trading system ... or broker or dealer shall display, rank, or accept from any person a bid or offer, an order, or any indication of interest in any NMS stock<sup>5</sup> priced in an increment smaller than \$0.01,” unless the price of the quotation is less than \$1.00, in which case the minimum increment is \$0.0001. In adopting Rule 612, the Commission noted that “Rule 612 will deter the practice of stepping ahead of exposed trading interest by an economically insignificant amount.” *See* Exchange Act Release No. 51808, at 219 (June 9, 2005), 70 Fed. Reg. 37496 (June 29, 2005).

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<sup>5</sup> Rules 600(b)(46) and 600(b)(47) of Regulation NMS provide that an NMS stock is a non-option security “for which transaction reports are collected, processed, and made available pursuant to an effective transaction reporting plan ....”

12. During the relevant period, UBS ATS's Form ATS indicated that UBS ATS complied with Rule 612. UBS ATS's Form ATS reported that "[o]nly orders priced in penny increments will be accepted by the UBS ATS." In the same document, UBS indicated that "[t]he UBS ATS will screen for orders priced in increments other than pennies ...."

13. Despite those representations and from at least May 2008 through March 2011, UBS accepted and ranked hundreds of millions of orders priced in sub-penny increments. Those sub-penny orders were generated in the following ways: (a) as a result of the PPP order type, (b) as a result of the Whole Penny Offset order type, and (c) as a result of various technical or coding problems, at least one of which UBS did not remedy in a timely fashion.

#### *PrimaryPegPlus Orders*

14. Following the order type's internal approval at UBS, UBS ATS accepted and ranked PPP orders for execution from June 2010 through March 2011. Throughout that period, a large number of PPP orders were accepted and ranked by UBS ATS, resulting in executions on a daily basis.

15. The price of a PPP order was fixed to – or “pegged to” – the national best bid or the national best offer (prices that are referred to collectively as the “NBBO”<sup>6</sup>) *plus or minus* a subscriber-entered percentage of the “spread.”<sup>7</sup> Therefore, PPP allowed a UBS ATS subscriber to place an order at numerous price points greater than the national best bid and less than the national best offer.

16. Because the second component of the formula determining the price of a PPP order – a subscriber-determined percentage of the spread – nearly always yielded a sub-penny amount, PPP orders were nearly always priced in illegal, sub-penny increments. (Even the UBS ATS user manual described PPP by using an example in which – when the national best bid (“NBB”) was \$50.00 and the national best offer (“NBO”) was \$50.02 – PPP yielded an illegal, sub-penny price: “Example: NBBO 50.00 x 50.02 – Primary peg BUY order, plus 10% - order is resident in the ATS at effective price 50.002.”) UBS ATS accepted and ranked such sub-penny PPP orders, even though Rule 612 of Regulation NMS barred it from doing so and UBS ATS's Form ATS indicated it would not do so.

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<sup>6</sup> Rule 600(b)(42) of Regulation ATS provides that, with respect to quotations for an NMS stock, the NBBO is typically the best (*i.e.*, highest) bid price and the best (*i.e.*, lowest) offer price for that stock “that are calculated and disseminated on a current and continuing basis by a plan processor pursuant to an effective national market system plan....”

<sup>7</sup> For the purpose of calculating the price of a PPP order, the “spread” was the difference between the national best bid for a stock and the national best offer for that stock. For example, if the national best bid for a stock was \$50.00 and the national best offer was \$50.02, the spread was \$0.02.

17. Generally, UBS ATS operated based upon principles of price-time priority. The best-priced marketable order for a security – *i.e.*, the highest bid or lowest offer – had priority in the dark pool’s order queue and was executed before all others and if two bids or two offers shared the same price the first one received by the ATS had priority in the queue. Thus, UBS ATS would execute a marketable PPP order to buy at \$50.002 per share before an order to buy the same security at \$50.00 per share. As a result, the PPP order type facilitated the very result that Rule 612 was designed to prevent: it allowed one subscriber to gain execution priority over another in the order queue by offering to pay an economically insignificant sub-penny more per share. Further, because UBS ATS allowed its subscribers to place orders at prices that were unavailable at ATSs and exchanges that complied with Rule 612 of Regulation ATS, UBS ATS obtained an unfair competitive advantage over those venues in its efforts to attract and execute orders from market participants.

18. When a resting PPP order executed in UBS ATS, the order that executed against it – such as one from a retail broker-dealer – received a slightly better execution price than if the trade had occurred at the bid or offer. Referred to as “price improvement,” the magnitude of that improvement was dictated by the percent of spread component of the PPP order. (In the example above, a sell order pegged to the bid – \$50.00 per share – could execute against the resting PPP buy order at \$50.002, receiving price improvement of 10 percent of the spread or \$0.002.) UBS employees understood that certain UBS ATS subscribers would want to use PPP to gain execution priority over orders in the queue that were simply pegged to the bid or the offer, in return for providing some price improvement.

19. When PPP was launched in June 2010, PPP orders could move ahead of orders pegged to the bid or the offer in the queue by providing only a minimal amount of price improvement, *i.e.*, one percent of the spread. Concerned that this increment was too small, UBS raised the minimum percent of spread for PPP orders to 10 percent on August 3, 2010, but did not amend UBS ATS’s Form ATS to reflect that change. As a result of that change, a firm that engaged in high-frequency trading and market making (“Subscriber A”) stopped using PPP.

20. UBS did not disclose the existence of PPP to all UBS ATS subscribers. Instead, more than three months before PPP’s launch in June 2010, UBS employees began pitching PPP to some potential subscribers and to a subset of the ATS’s existing subscribers. Recipients of that pitch received an updated version of the UBS ATS user manual – the “Rules of Engagement” – that provided the coding instructions a subscriber needed to place a PPP order.<sup>8</sup>

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<sup>8</sup> The instructions to Form ATS provide that an ATS must attach to its Form ATS “[a] copy of the alternative trading system’s subscriber manual and any other materials provided to subscribers.” The Rules of Engagement, a document provided to a number of UBS ATS subscribers, included information that subscribers needed to use the ATS and that was of the sort one would reasonably expect to find in a subscriber manual. Nevertheless, prior to December 2011, UBS ATS’s Form ATS and amendments thereto

21. UBS employees believed the PPP order type would be particularly well-suited to the trading strategies of market makers and HFT firms, which typically traded at or near the best bid or offer. Accordingly, nearly all of the subscribers who received the pre-launch notice of PPP were market makers and/or HFT firms.

22. On at least one occasion, UBS employees discussed the possibility of disclosing PPP broadly or to all of the ATS's subscribers. In May 2010, approximately one month before PPP's June 2010 launch, a UBS employee responsible for communicating with potential and existing subscribers to UBS ATS emailed the principal for UBS ATS. Mentioning a firm that engaged in high-frequency trading and market making and that had recently been pitched PPP (an order type that UBS employees referred to as "percent of spread"), the employee wrote, "[I]everaging the % of spread may be a way to help get [Subscriber A] in the black and generate some added flow from other subscribers. We should explore the impact and make sure all of our ATS client[s] are aware of the new % of spread functionality as well. If we haven't already we should consider creating an ATS client distribution list for these types of announcements." The ATS principal responded, "I would like to not push % of spread to[o] hard to the full subscriber base, until we see the results with [Subscriber B and Subscriber A]," two firms that engaged in high-frequency trading and market making. The other employee responded, "yep..makes sense."

23. At the time the order type was launched, UBS did not disseminate a notice to all of the ATS's subscribers advising them of the PPP order type. Prior to July 2012, UBS had no policy or procedure requiring the Rules of Engagement to be sent to all subscribers every time it was amended. Typically, UBS sent an up-to-date version of the Rules of Engagement to new subscribers and to any existing subscriber that asked for them. (At that time, PPP was described on page 10 of the 17-page Rules of Engagement.) Even though they were UBS ATS subscribers in June 2010, several entities were emailed a PPP-referencing version of the Rules of Engagement months later, and well after the order type was launched.

24. In July 2010, a UBS employee emailed an employee of a potential subscriber to the UBS ATS, cutting-and-pasting into his email the lengthy coding instructions that a subscriber needed to place orders on UBS ATS. Before sending the email and for reasons that included a prior business dispute between UBS and the potential subscriber, the UBS employee intentionally removed the portion of those instructions that described PPP and that provided the instructions needed to enter PPP orders. While the entity subsequently traded on the ATS, UBS never provided it with notice of PPP.

25. In October 2010, the same employee was asked to review a draft PowerPoint marketing presentation that mentioned PPP ("New Order Types & Functionality: % of Spread") and the natural-only crossing restriction ("Intelligently leverage UBS ATS → Non natural vs. Natural designation"). The employee removed both of those references from the presentation. In an email attaching his edits to the PowerPoint deck, the employee wrote to

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reported that "UBS ATS does not have a subscriber manual" and did not attach a copy of the Rules of Engagement.

another UBS employee, “I took out references to our % of spread and non-natural vs natural as well because that stuff is very proprietary and changes.. It’s something we should talk to rather than put in the slide....”

26. In March 2011, UBS sent a spreadsheet containing certain trading information to a firm that engaged in high-frequency trading and market making (“Subscriber C”) in an effort to encourage its expanded usage of PPP. For each of the thousands of orders Subscriber C had executed in UBS ATS on two prior trading days, the spreadsheet showed, without providing any customer-identifying information, whether the firm’s order had executed against a retail order or a non-retail order. (Such information was not data that UBS typically disclosed to other UBS ATS subscribers and was not information that subscribers could readily ascertain through other means.) The UBS employee that proposed sending the spreadsheet to Subscriber C understood that Subscriber C wanted to use the spreadsheet’s data to adjust its algorithmic trading strategies in ways that would increase the likelihood of its PPP orders executing against orders from retail broker-dealers.

27. On March 11, 2011, and after a Commission examination team had identified PPP and raised concerns that it might violate Rule 612 of Regulation NMS, UBS decommissioned the PPP order type. At that time, a number of the ATS’s subscribers still had not received notice of PPP’s existence: UBS never provided a PPP-referencing version of the Rules of Engagement to at least one entity that became a subscriber of UBS ATS after PPP’s June 2010 launch and UBS never provided such notice to about eight of the approximately 35 entities that were already ATS subscribers in June 2010. Notice of the existence and selective disclosure of the PPP order type would have been important to subscribers.

#### *Whole Penny Offset Orders*

28. From 2008 until it was decommissioned in June 2010, a second order type – referred to in this Order as the Whole Penny Offset order type – permitted subscribers in certain instances to place orders priced in sub-penny increments that were accepted and ranked by UBS ATS.

29. The Whole Penny Offset order type allowed subscribers to enter orders priced at the NBB, the NBO, or the midpoint of the NBBO (*i.e.*, the average of the national best bid and national best offer), *plus or minus* \$0.01. The order type yielded orders priced in impermissible sub-penny increments whenever the price of the order was pegged to the midpoint and the spread between the national best bid and national best offer was an odd number of cents, *e.g.*, if the national best bid and offer were \$30.00 and \$30.03, the midpoint would be \$30.015 and orders plus and minus the one-cent offset would be illegally priced at \$30.005 and \$30.025 per share. Between January 2009 and June 2010, Whole Penny Offset orders resulted in executions for approximately 1.5 million shares of stock on UBS ATS.

### *Additional Orders Priced in Sub-Penny Increments*

30. In addition to the violative orders placed as a result of the PPP and Whole Penny Offset order types, UBS accepted and ranked tens of millions of other orders priced above \$1.00 in sub-penny increments. Those sub-penny orders resulted from at least two technical problems.

31. The first technical problem, which caused the overwhelming majority of the additional sub-penny orders, involved a coding error in UBS's smart order router, an application that utilized pre-programmed logic to route or direct orders to UBS ATS and to other venues for execution. When seeking to place an order in UBS ATS at the NBBO midpoint, UBS's smart order router would send an immediate-or-cancel limit order that was explicitly denominated at the price the router had calculated to be the midpoint of the NBBO, rather than sending an order with a price that was *pegged* to the midpoint of the NBBO.<sup>9</sup> To the extent those orders sent by the router to UBS ATS were sub-penny-priced, UBS ATS failed to identify and reject them and, instead, accepted them in violation of Rule 612 of Regulation NMS. After discovering this coding error in May 2010, UBS fixed it within a few weeks.

32. The second technical problem arose from defects in UBS's algorithmic trading platform – called PTSS – that generated sub-penny orders which, in some instances, were routed to third-party venues for execution and, in others, were routed to UBS ATS, which accepted and ranked them. PTSS's problems persisted as a result of numerous delays in the rollout of a replacement algo platform called Rainier.

33. In March 2010, after receiving an automated report indicating that UBS had routed over a thousand PTSS-generated sub-penny orders to third-party venues on the prior trading day, a UBS compliance officer wrote, “[w]e need to have some system control in place to prevent sub penny pricing violations caused by bad market data feeds. . . . Please let me know what can be done to prevent recurrence of this issue going forward.”

34. Aware that PTSS was the cause of the sub-penny orders, another UBS employee proposed awaiting the rollout of the replacement algo platform rather than immediately remedying the issue with PTSS. “We plan to decommission PTSS in two months,” he wrote in an internal email. “Our new algo system Rainier doesn't have the issue. Since it happened rarely, we would like to make no change to PTSS, and let the migration take care of the issue.”

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<sup>9</sup> While an ATS does not violate Rule 612 by accepting and ranking an order *pegged* to the midpoint of the NBBO (even if the midpoint is a sub-penny price), this limited exception does not permit an ATS to accept and rank an order that is explicitly denominated in a sub-penny price (even if that sub-penny price is equal to the midpoint of the NBBO). See Exchange Act Release No. 51808, at 231 (“Rule 612 will not prohibit a sub-penny execution resulting from a midpoint or volume-weighted algorithm or from price improvement, so long as the execution did not result from an impermissible sub-penny order or quotation.”).

35. Nearly four months later, on July 13, 2010, a UBS employee again reported in an internal email that UBS was routing PTSS-generated sub-penny orders to third-party venues for execution. The UBS ATS principal responded by explaining that the problem would be resolved by the upcoming migration from PTSS to Rainier. “If we confirm this pricing decision came from PTSS classic,” he wrote, “can we not spend to[o] much time on research – we know classic has this issue, its being phased out, and we have dug through examples – to[o] many times already.” On July 14, 2010, the UBS ATS principal and other UBS employees received a message reporting that UBS had routed over 17,000 additional PTSS-generated sub-penny orders to third-party venues on the prior trading day.

36. On August 6, 2010, after receiving an additional report of seventy-one PTSS-generated orders being routed to third-party venues and being assured by another UBS employee that the PTSS order flow would be migrated to Rainier “in the next few weeks,” the UBS compliance officer responded: “Can we get a hard date [for the decommissioning of PTSS classic]? This has been going on for months – and we have been saying a few weeks for quite some time – I need a hard cut-off date.” Nevertheless, sub-penny orders continued to be generated by PTSS and accepted by UBS until at least September 2010.

#### Natural-Only Crossing Restriction

37. Since March 2010, certain orders – those entered on behalf of UBS clients that pay to utilize UBS-developed algorithms – have had the ability to avoid executing in UBS ATS against orders entered by subscribers that UBS has deemed “non-natural.” This feature protects those algorithmic orders – and only those orders – from executing against orders from market makers/HFT firms. No other user of or subscriber to the UBS ATS has had the ability to utilize this natural-only crossing restriction.

38. Prior to July 2012, a significant number of UBS ATS subscribers had received no notice of the natural-only crossing restriction’s existence and some non-natural subscribers – who had not been told of their “non-natural” designation – remained unaware that they had been effectively barred from executing against millions of the orders placed in UBS ATS by UBS algorithms. Beginning no later than March 2010, a large number of algorithmic orders invoking the natural-only crossing restriction were accepted and ranked by UBS ATS, resulting in executions on a daily basis.

39. By early 2010 and in anticipation of the natural-only crossing restriction’s launch, UBS used subjective criteria to identify UBS ATS subscribers and accounts that utilized “non-natural” trading strategies and those that did not. Subsequently, UBS made that determination by using a UBS-created quantitative metric that assessed the correlation between a subscriber’s executions and movements in market prices in the second after the execution.

40. Historically, the list of firms that UBS has deemed “non-natural” has been comprised largely or entirely of market makers and HFTs. In a disclosure provided to all ATS subscribers in July 2012, UBS described non-natural order flow as orders placed by “a category of subscribers whose order flow is determined by the UBS ATS to be more short

term and opportunistic in nature and where the position would likely be immediately reversed, such as market making, liquidity provision and arbitrage.”

41. Clients utilizing UBS’s algorithms typically paid more to trade a share of stock in UBS ATS than direct subscribers to the ATS did and UBS employees sought to shield certain order flow of UBS’s algorithmic clients from any negative impacts of interacting with non-natural order flow. In a January 2010 email, a UBS employee responsible for its algorithmic trading products wrote that the firms to be “tagged as ‘non-natural’” were mainly “high freq firms and market makers” and that “[i]nitially we do not want to expose our discretionary dark liquidity to this flow.”

42. As early as 2010, UBS employees understood that non-natural subscribers would want to know about the crossing restriction’s existence and those employees debated disclosing it to subscribers. For example, in September 2010, two UBS employees with responsibility for the ATS had the following instant message exchange concerning whether to make such a disclosure to Subscriber C, a firm that had been deemed “non-natural”:

*Employee 1:* hey – do you want to tell [Subscriber C] that you labelled them as awful [*sic*] bad liquidity? [...] opps ... I mean ... non-natural [...] I think we should

*Employee 2:* negative [...] raises too many questions for something that in the end [...] will be almost not noticeable [...] our clients do not need to understand how and when our algos trade against them ... thats to our discretion

43. As was noted in paragraph 25, in one instance in October 2010, mention of the natural-only crossing restriction was removed from a draft UBS ATS marketing presentation. When removing it, a UBS employee noted that the restriction was “proprietary [and] . . . something [they] should talk to rather than put in the slide.”

44. Pre-November 2011 versions of the Rules of Engagement did not disclose the natural-only crossing restriction and included two statements that were rendered false or misleading by the crossing restriction’s existence.

- a. *First*, the Rules represented that “[o]rders sent to the UBS ATS will be given priority based on price first and receipt time second.” That statement was false because it failed to disclose that the natural-only crossing restriction – and not simply an order’s price and receipt time – could determine whether or not an order would be executed.
- b. *Second*, the Rules represented that “[s]ubscriber orders that are placed in the UBS ATS will have an opportunity to interact with UBS BD’s US equity order flow – liquidity that includes ... algorithmic trading orders.” In fact, orders received from non-natural subscribers were ineligible to execute in UBS ATS against the significant portion of UBS algorithmic trading orders that made use of the crossing restriction.

45. UBS ATS's Rules of Engagement was amended in November 2011 to include a disclosure of the natural-only crossing restriction. However, the revised rules were not distributed to all subscribers until July 2012, when UBS revised its internal policies and procedures to require prompt distribution to all subscribers of changes to the Rules of Engagement.

46. Prior to December 2011, UBS ATS's Form ATS and amendments thereto failed to report the natural-only crossing restriction's existence or the fact that it was available only to orders placed via UBS algorithms.

47. Knowledge of UBS ATS's implementation of its non-natural designation and trading restriction would have been important to natural and non-natural subscribers. However, while some non-natural subscribers were told about the crossing restriction and their non-natural status prior to July 2012, at least some subscribers received no written or oral notice of the crossing restriction's existence until that time.

48. In July 2012, the Rules of Engagement was distributed simultaneously to all subscribers for the first time and that version of the document included a description of the natural-only crossing restriction. Although UBS gave at least some non-natural subscribers oral and/or written notice of their non-natural status prior to August 2012, it did not provide all non-natural subscribers with written notice of their status until then.

#### Fair Access

49. Rule 301(b)(5) of Regulation ATS requires an ATS with at least five percent of the average daily volume for any covered security (the "fair access threshold") during four of the preceding six months to comply with "fair access" requirements. Under Rules 301(b)(5)(ii)(A), (B), and (D) of Regulation ATS, those requirements include: (a) establishing written standards for granting access to trading on its system, (b) not unreasonably prohibiting or limiting any person in respect to access to services offered by the ATS, and (c) reporting all grants, denials, and limitations of access (and the reasons for granting, denying, or limiting access) with respect to such security on its quarterly Form ATS-R. Exchange Act Release No. 40760 (December 8, 1998), 68 SEC Docket 2188, 2217-2218. For equity securities, the fair access requirements apply on a security-by-security basis. Exchange Act Release No. 40760, 68 SEC Docket at 2217. A denial of access is reasonable if it is based on objective standards that are applied in a fair and non-discriminatory manner. *In the Matter of INET ATS, Inc.*, Exchange Act Rel. 53631 (April 12, 2006).

50. In June 2011 and from August 2011 through November 2011, as a result of a lapse in monitoring, UBS ATS crossed the fair access threshold during four of the preceding six months with respect to as many as four covered securities. Therefore, with respect to those securities during that time period, UBS ATS was subject to the fair access requirements of Regulation ATS and was required, among other things, to report all of its grants, denials, and limitations of access (and, for each applicant, its reasons for granting, denying, or limiting access) on its quarterly Form ATS-R.

51. During that time period, UBS ATS did not have written standards for granting access to trading on its system, in particular, with respect to granting access to the natural-only crossing restriction, which was available only to orders generated by certain UBS algorithms.

52. Under Rule 301(b)(5)(ii)(B) of Regulation ATS and with respect to covered securities for which UBS ATS had crossed the fair access threshold for the requisite time period, the natural-only crossing restriction was an ATS function to which UBS could not unreasonably prohibit or limit access in an unfair or discriminatory manner. UBS's failure to permit UBS ATS subscribers access to this function was not based upon a fair and non-discriminatory application of objective standards and, therefore, did not comply with Rule 301(b)(5)(ii)(B).

53. UBS ATS filed three Forms ATS-R with the Commission concerning the periods in which it exceeded the fair access threshold for one or more covered securities in four of the six preceding months. With respect to those securities, in each of those Forms ATS-R, UBS ATS was required to disclose, but did not disclose, all required grants, denials, and limitations of access, including with respect to the natural-only crossing restriction.

#### Order Book Access

54. Rule 301(b)(10) of Regulation ATS provides that an ATS "shall establish adequate safeguards and procedures to protect subscribers' confidential trading information," including "[l]imiting access to the confidential trading information of subscribers to those employees of the alternative trading system who are operating the system or responsible for its compliance with these or any other applicable rules."

55. Prior to August 2012, 103 UBS employees (primarily IT personnel) who neither operated UBS ATS nor had responsibility for its compliance functions had full, live access to data concerning orders pending in UBS ATS, *i.e.*, the ATS's order book.

#### Record Preservation

56. Section 17(a) of the Exchange Act and Rule and 17a-4(b)(1) thereunder require broker-dealers to keep for prescribed periods and preserve a "memorandum of each brokerage order, and of any other instruction ... show[ing] the terms and conditions of the order ...." Rules 301(b)(8) and 303 of Regulation ATS impose record preservation obligations on ATSS and require them to preserve records of "[t]he designation of [an] order as a market order, limit order, stop order, stop limit order, or other type of order."

57. For at least the periods August 2008 through March 2009 and August 2010 through November 2010, UBS failed to keep for prescribed periods and preserve records of certain order information for UBS ATS, including data indicating whether orders had utilized the natural-only crossing restriction.

## Violations

58. As a result of the conduct described above, UBS willfully<sup>10</sup> violated:
- a. Section 17(a)(2) of the Securities Act, which prohibits, directly or indirectly, in the offer or sale of securities, obtaining money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading;
  - b. Section 17(a) of the Exchange Act and Rule 17a-4(b)(1) thereunder, which require brokers and dealers to keep for prescribed periods and preserve certain records;
  - c. Rule 301(b)(2) of Regulation ATS, which requires an ATS to file an initial operation report on Form ATS at least 20 days prior to commencing operation as an alternative trading system and to file an amendment on Form ATS at least 20 days prior to implementing a material change to the operation of the ATS, within 30 days after the end of a quarter when information contained in an initial operation report filed on Form ATS becomes inaccurate, and promptly upon discovering that an initial operation report filed on Form ATS or an amendment on Form ATS was inaccurate when filed;
  - d. Rule 301(b)(5)(ii)(A) of Regulation ATS, which requires an ATS that crosses the fair access threshold during four of the preceding six months in a covered security to establish written standards for granting access to trading on its system;
  - e. Rule 301(b)(5)(ii)(B) of Regulation ATS, which requires an ATS that crosses the fair access threshold during four of the preceding six months in a covered security to not unreasonably prohibit or limit any person in respect to access to services offered by the ATS with respect to such security by applying standards required by Rule 301(b)(5)(ii)(A) in an unfair or discriminatory manner;
  - f. Rule 301(b)(5)(ii)(D) of Regulation ATS, which requires an ATS that crosses the fair access threshold during four of the preceding six months in a covered security to report all grants, denials, and limitations of access (and

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<sup>10</sup> A willful violation of the securities laws means merely ““that the person charged with the duty knows what he is doing.”” *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000) (quoting *Hughes v. SEC*, 174 F.2d 969, 977 (D.C. Cir. 1949)). There is no requirement that the actor ““also be aware that he is violating one of the Rules or Acts.”” *Id.* (quoting *Gearhart & Otis, Inc. v. SEC*, 348 F.2d 798, 803 (D.C. Cir. 1965)).

the reasons, for each applicant, for granting, denying, or limiting access) with respect to such security on its quarterly Form ATS-R;

- g. Rules 301(b)(8) and 303 of Regulation ATS, which require an ATS to preserve certain records;
- h. Rule 301(b)(10) of Regulation ATS, which requires an ATS to establish adequate safeguards and procedures to protect subscribers' confidential trading information and to adopt and implement adequate oversight procedures to ensure that the safeguards and procedures for protecting subscribers' confidential trading information are followed; and
- i. Rule 612 of Regulation NMS, which provides that "[n]o ... alternative trading system ... or broker or dealer shall display, rank, or accept from any person a bid or offer, an order, or an indication of interest in any NMS stock priced in an increment smaller than \$0.01," unless the bid or offer, order, or indication of interest is priced less than \$1.00 per share, in which case the minimum increment is \$0.0001.

#### IV.

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

Accordingly, pursuant to Section 8A of the Securities Act and Sections 15(b) and 21C of the Exchange Act, it is hereby ORDERED that:

A. UBS cease and desist from committing or causing any violations and any future violations of Section 17(a)(2) of the Securities Act, Section 17(a) of the Exchange Act and Rule 17a-4(b)(1) thereunder, Rules 301(b)(2), 301(b)(5)(ii)(A), 301(b)(5)(ii)(B), 301(b)(5)(ii)(D), 301(b)(8), 301(b)(10) and 303 of Regulation ATS, and Rule 612 of Regulation NMS.

B. UBS is censured.

C. UBS shall, within ten days of the entry of this Order, pay a civil money penalty in the amount of \$12,000,000.00, disgorgement of \$2,240,702.50 and prejudgment interest of \$235,686.14 to the Securities and Exchange Commission for transfer to the U.S. Treasury. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. 3717 and SEC Rule of Practice 600. Payment must be made in one of the following ways:

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

- 2) UBS may make direct payment from a bank account via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofm.htm>; or
- 3) UBS may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

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

Payments by check or money order must be accompanied by a cover letter identifying UBS as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Amelia Cottrell, Associate Regional Director, Division of Enforcement, Securities and Exchange Commission, Brookfield Place, 200 Vesey Street, Suite 400, New York, NY 10281.

By the Commission.

Brent J. Fields  
Secretary