

## Reuters

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### Analysis: UBS faces wave of Lehman note legal woes

By Joseph Giannone

Even as UBS launches a global campaign to revive its banged-up brand, the Swiss bank's U.S. brokerage faces another costly and embarrassing wave of regulatory actions.

Investor lawyers for the past year have been taking UBS to task for selling debt with such reassuring names as "100 percent principal-protected notes" that promised robust returns with no risk of loss. These notes were largely wiped out when the investment bank went bankrupt in September 2008.

A string of arbitration losses over the past year may soon be followed by a round of state lawsuits, class actions and possibly intervention by the Securities and Exchange Commission and the Financial Industry Regulatory Authority.

**"UBS is something of a house on fire right now," said Jacob Zamansky, a New York lawyer who helped a South Carolina woman win the first Lehman note arbitration case last year. "They're doing poorly in arbitration. What happens when FINRA and the SEC get involved?"**

After Lehman, UBS was the largest seller of Lehman protected notes -- zero-

coupon Lehman debt linked to an index or a basket of other securities. These so-called structured products offer limited gains with the assurance that investors would get their money back if the linked securities fell.

UBS sold more than \$1 billion of these structured notes.

Unfortunately for investors, these notes were ultimately just unsecured Lehman debt. UBS brokers continued to sell these notes to retail investors through 2008 even as Wall Street grew worried about Lehman's financial strength.

"What we've learned is there were serious concerns inside UBS about these things, certainly during the spring of 2008," said Phil Aidikoff, whose law firm Aidikoff, Uhl & Bakhtiari has represented investors.

#### **'Followed the Rules'**

Lawyers representing dozens of cases and a few state officials contend the notes were unsuitable for small investors, who were lulled by the "principal protected" name.

UBS said it was "following all regulatory requirements, well-established sales practices and client disclosure

guidelines" when it sold these notes. "Any client losses were the direct result of the unexpected and unprecedented failure of Lehman Brothers."

So far, it appears arbitrators are siding with investors, who have prevailed in five of six rulings, according to FINRA arbitration documents.

In some cases investors are receiving full restitution -- a rarity -- and even legal and expert fees. Lawyers said UBS is now settling more of these cases outside of arbitration.

Soon, state and federal groups will join the fray.

The Swiss bank in its latest quarterly financial report warned it is named in class-action suits and "numerous" investor arbitrations, while also receiving inquiries from "state regulators and FINRA."

New Hampshire led the charge in June 2009 when it became the first state to allege "unfair sales practices" and "recommending unsuitable investments" to more than 40 state residents.

"We believe 'principal protection' meant one thing to investors, but something entirely different to UBS," Kevin Moquin, a New Hampshire attorney, said at the time.

Missouri, which took a lead role pursuing auction rate securities complaints, is one of several states that are also probing UBS and its Lehman note sales, Missouri Securities Commissioner Matt Kitzi said.

"These are complex products that investors are expressing some concern and confusion over," said Kitzi.

Industry watchdogs have been slower to respond. FINRA in December advised brokers that promotional materials must not overstate the level of protection, though it stopped short of banning use of the term "principal protected."

SEC staffers last month began examining how banks described risks of structured note offerings and whether "principal protection" was deceptive.

## **'Impact'**

The potential damage to UBS could be significant in terms of both financial burden and reputation.

UBS recorded \$900 million in charges related to auction rate securities, long touted as a high-yielding cash equivalent. These securities, of which UBS sold \$22 billion, became impossible to sell when markets seized up in 2007.

State regulators two years ago said UBS continued selling these securities even as the bank's executives privately worried markets were crumbling. UBS, like other banks, was forced to repurchase these securities from investors.

So far arbitrators seem to be taking a stern view of UBS. Notably, one investor received full restitution of \$432,000 plus \$53,000 in attorney fees.

"This was the panel's way of telling UBS this was an egregious situation," said Seth Lipner of Deutsch & Lipner, whose Garden City, New York, firm represented that investor and has filed more than a dozen cases.

Beyond the financial burden, the Lehman notes may put further strain on a brokerage hard hit by a series of market missteps and regulatory run-ins.

UBS suffered \$52 billion of losses on ill-timed U.S. subprime markets, the biggest losses by a European bank during the credit crisis. UBS had to be bailed out by Switzerland.

Then there was news that U.S. authorities accused UBS of helping Americans hide assets overseas and avoid taxes, and clients left in droves.

The question is whether the Lehman cases will further strain a brokerage force that lost more than a thousand advisers over the course of a year, driven away by round after round of bad news.

**"With UBS, it's just one thing after another," said Zamansky. "They're like the BP of Wall street."**