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November 23, 2012

Ms. Elizabeth M. Murphy  
Secretary  
Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549-1090

Re: File Number SR-NASDAQ-2012-090

Dear Ms. Murphy:

UBS Securities LLC (“UBS”) appreciates the opportunity to submit its views pursuant to Securities Exchange Act Release No. 34-68115 (the “Release”).<sup>1</sup> UBS is a registered broker-dealer and investment advisor that provides financial services to private, corporate and institutional clients.

As expressed in UBS’s August 22, 2012 letter (the “Prior Letter”) to the Securities and Exchange Commission (the “Commission”), which commented on Securities Exchange Act Release No. 34-67507, we are concerned that Nasdaq’s proposed amendments to Rule 4626 are grossly inadequate to address the harm caused by its systemic failures and unprecedented actions during the initial public offering of Facebook, Inc. on May 18, 2012 (the “Facebook IPO”).

On the day of the Facebook IPO, unbeknownst to the market, Nasdaq’s systems were incapable of completing the IPO Cross. Rather than delay the opening of Facebook trading to resolve the problem, Nasdaq improvised an untested technological “solution” whereby it switched the Facebook IPO to a secondary system that had never been tested for use in the Facebook IPO. Among the problems caused by this last-minute and undisclosed change of plans was Nasdaq’s failure to issue execution reports from the IPO Cross, leaving market participants in the dark for hours as to the fundamental fact of whether they had bought or sold Facebook stock. In fact, for the first nearly 30 minutes of trading, market participants were not even told that Nasdaq had taken the extraordinary step of commencing trading notwithstanding its inability to issue the IPO cross execution reports—something that was unprecedented in the history of the exchange.

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<sup>1</sup> Oct. 26, 2012; Fed. Reg. Vol. 77, No. 213, 66197 (Nov. 2, 2012).

Nasdaq’s decision to commence trading despite its undisclosed failure to issue execution reports had devastating implications throughout the market. At UBS, it caused tremendous, unanticipated stress on its retail market making system, which led to UBS acquiring a substantial unintended long position in Facebook.<sup>2</sup> The market and its participants operate with the expectation that exchanges will use standard protocols and tested technology—which interact in known and predictable ways with market participants’ systems—to ensure fair and orderly trading. It is therefore inconceivable that Nasdaq failed to appreciate that its haphazard, untested technological “fix” had the potential to cause catastrophic consequences for participants in the Facebook IPO. Nasdaq was reckless to subject an unknowing market to its last-minute experimentation and Nasdaq should make market participants whole for the harm it caused. Nasdaq’s proposed amendments to Rule 4626 do not come close to doing so.

As set forth in its Prior Letter, UBS is of the view that: (i) \$62 million is not remotely sufficient to provide restitution to the market participants who were harmed as a direct result of Nasdaq’s systems failures and reckless decision-making during the Facebook IPO; (ii) the types of claims eligible for compensation under the proposed Accommodation Fund are too narrowly defined and should be expanded to include the full extent of losses that Nasdaq caused, and (iii) the requirement that program participants release categories of claims that are not addressed by Nasdaq’s proposal is fundamentally unfair. Rather than detail again the concerns outlined in our Prior Letter, we offer below additional comments regarding the manner in which we believe these issues should be addressed consistent with the overarching goal of Section 6(b)(5) of the Securities Exchange Act of 1934 (the “Exchange Act”) to protect investors and the public interest. Additionally, some of the comment letters to date have raised questions relating to regulatory immunity from private suits and limitations on liability that we believe are unnecessary for the Commission to address in the context of the proposed rule change.

**1. *The size of the proposed accommodation fund should be increased and the scope of eligible orders should be expanded.***

We submit that Nasdaq should increase the size of the accommodation fund and expand the types of trading losses eligible for compensation in a manner that better reflects the massive damage Nasdaq caused market participants through its gross mishandling of the Facebook IPO.

First, market participants reportedly lost, in the aggregate, more than \$500 million due to Nasdaq’s systemic failures. UBS alone suffered losses in excess of \$350 million. Nasdaq’s arbitrary \$62 million cap on total market recovery for losses it caused in connection with the Facebook IPO is thus disproportionate and woefully inadequate. Indeed, the proposed rule, which calls for prioritizing payment of claims in two “tranches” “based on the extent to which the claimant has compensated its customers,”<sup>3</sup> by its very structure contemplates that the \$62 million will be insufficient to cover even the extremely limited categories of losses eligible for

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<sup>2</sup> See Prior Letter at p. 2 for a description of how UBS’s system stress resulted in this long position.

<sup>3</sup> Nasdaq SEC Submission p. 34.

compensation under the current proposal, given that (i) many or all of the claimed losses will not be paid in full; and (ii) the second tranche of claimed losses may not be reimbursed at all.<sup>4</sup>

Second, with respect to the claims deemed eligible for compensation by its proposal, as detailed in our Prior Letter, Nasdaq has adopted an unreasonably narrow definition of qualifying losses. In particular, the proposal disregards a very significant portion of the damage caused by Nasdaq by expressly excluding all losses resulting from “individual member firm technology issues or system failures, or member firm operational issues or operational failures,” notwithstanding that these downstream problems would not have occurred absent Nasdaq’s unprecedented failure to issue execution reports for trades executed in the IPO Cross before commencing trading in Facebook stock. The problems were exacerbated by Nasdaq’s silence on the issue for the first approximately thirty minutes of trading, and by its failure to come up with a means of issuing the reports for approximately two hours after trading opened. Market participants who suffered such losses due to Nasdaq’s system failures and reckless conduct are deserving of compensation and we urge the Commission to condition rule approval on modification of the eligibility categories to account for these types of losses.

**2. *The requirement of a release of claims that are not covered by the proposed accommodation program is fundamentally unfair and should be struck from the proposal.***

As UBS previously commented, the requirement in Nasdaq’s proposed amendments that participants in the member accommodation program release Nasdaq from *all* claims related to the Facebook IPO as a condition of receiving compensation through the program is fundamentally unfair. We agree that there should be a limitation to prevent duplicative recovery. However, the more appropriate course would be to treat any recovery pursuant to the program as a setoff against future claims, rather than use program participation to institute a bar on any and all future claims against Nasdaq, including claims for losses that are not even eligible for compensation under the program.<sup>5</sup>

To the extent a release requirement is deemed by the Commission to be a necessary aspect of the proposed accommodation program, the scope of any release should be limited to the categories of compensable losses. It is evident that the program is oriented to losses experienced by the customers of Nasdaq’s members. Nasdaq expressly stated that “accommodation payments received by members from Nasdaq should be used for the benefit of [the members’] customers” who “have been impacted by the processing of member orders in the FB Cross.”<sup>6</sup>

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<sup>4</sup> Under Nasdaq’s proposal, if the first tranche of claims “exceed \$62 million, accommodation will be prorated among members eligible to receive accommodation under tranche [one]” and members eligible to receive accommodation under tranche two will receive nothing. Nasdaq SEC Submission p. 27.

<sup>5</sup> Nasdaq says that the release requirement is “aimed at avoiding unnecessary litigation and ensuring equal treatment of all members receiving funds under the [accommodation] [p]roposal,” but the proposal in its current form is unlikely to accomplish either goal. Given the extreme limitations on amount of recovery and types of compensable claims discussed in Section 1 above, the release requirement likely will deter those who suffered the greatest harm from participating in the Program. In that case, Nasdaq will spend the entire \$62 million allocated sum despite not addressing those who suffered the largest losses and thus will not significantly reduce its litigation exposure.

<sup>6</sup> Nasdaq SEC submission p. 24. Pursuant to this tiered compensation structure, if members’ claims for customer compensation are greater than the allotted \$62 million pool, two things will happen: (i) the eligible program participants will not receive the full amount they compensated their customers, but rather will receive a prorated

Further, the proposal calls for all customer compensation claims to be paid before any proprietary claims are even considered. Given that customer compensation claims are likely to account for most, if not all, of the \$62 million allocated for the accommodation program, the broad release requirement as proposed by Nasdaq—requiring release of even program-ineligible proprietary claims against Nasdaq—is heavy-handed. Just as claims for customer compensation and claims for proprietary losses are to be treated differently for payment purposes, so too should they be treated differently for purposes of requiring a release of claims.

UBS and other market participants should be able to seek to make their clients whole—through a program that is being proposed for that very purpose—without being forced to relinquish any and all claims for proprietary losses. UBS’s proprietary losses comprise the overwhelming majority of the damage it suffered in connection with the Facebook IPO, as we understand is the case for other Nasdaq members as well. By and large, these losses are not even eligible for compensation under the program, despite the fact that they resulted directly from Nasdaq’s systemic failures. Thus, Nasdaq’s position that it is necessary to condition the recovery of customer compensation on a release of such (ineligible) proprietary claims is unreasonable and fundamentally unfair.

Further, to the extent a release requirement is implemented, program participants should not be required to execute the release until they are notified of the amount they will recover from the program based on the initial claim submissions. In the course of the commenting process on the proposed rule amendments, Nasdaq has indicated that it “intends to implement the Accommodation Proposal such that a member will be aware of the results of its claim prior to being required to execute a release.”<sup>7</sup> Nasdaq also stated that it “does not object to the release becoming effective upon payment.”<sup>8</sup> As these positions were not evident in Nasdaq’s proposal, we urge the Commission to work with Nasdaq to ensure that revisions to the proposed rule amendments clearly reflect that the timing of a member’s execution of the release is tied not to its submission of an accommodation program claim, but rather to Nasdaq’s payment of accommodation program funds after the member has been informed of the value of its claim.

For these reasons, we strongly urge the Commission to work with Nasdaq to revise the proposed rule such that, to the extent there is a release requirement, it is without prejudice to any other legitimate claims a participant may have against Nasdaq for proprietary losses and is only required as a condition for final payment, not claim consideration.

**3. *The Commission should not address Nasdaq’s arguments about immunity or limitation of liability.***

While UBS agrees with those commenters who observed that Nasdaq is not entitled to immunity from liability here because it was acting in its “for profit” capacity in its handling of

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share of the \$62 million pool; and (ii) any program participants with eligible “Covered Proprietary Losses” will not receive any compensation for those claims. It therefore is entirely possible that a participating firm would be forced to execute a release of all possible claims against Nasdaq relating to the Facebook IPO, and yet ultimately receive no compensation because it sought compensation solely for proprietary losses.

<sup>7</sup> Nasdaq Sept. 17 Letter at p. 4, n. 9.

<sup>8</sup> *Id.*

the Facebook IPO, rather than in its “regulatory capacity” as a self-regulatory organization, these issues are not implicated by, and need not be addressed in, the current proceedings. As reflected in the Release, even the commenters who raised these points have acknowledged that they should not be considered in connection with Nasdaq’s accommodation proposal.<sup>9</sup> Nasdaq itself likewise has recognized that the Commission does not need to address the issue of regulatory immunity to perform its assessment of whether the proposed rule change is consistent with the Act.<sup>10</sup> Thus, while immunity and limitation of liability issues were raised in the comment process, they are a distraction from the proper focus of this rulemaking process and we therefore urge the Commission to ignore them in these proceedings. Should the Commission disagree and deem it appropriate substantively to address these issues, however, we ask that UBS and other market participants be given another opportunity to make oral or written submissions on the subject.

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UBS appreciates the opportunity to comment on the Release. Again, we commend the Commission for considering rule amendments that would facilitate the recovery of losses by market participants harmed by Nasdaq’s gross mismanagement of the Facebook IPO. The amendments proposed by Nasdaq, however, are neither fair nor equitable. Accordingly, we urge the Commission to consider UBS’s comments herein and in the Prior Letter before implementing any changes to Rule 4626.

Regardless of whether the rule amendments are effected, either in their current proposed form or pursuant to any modifications, UBS reserves all rights, without limitation, to seek full recovery for its losses arising from Nasdaq’s failures in connection with the Facebook IPO and to do so through all available means.

Respectfully submitted,

UBS Securities LLC

By: 

Mark Shelton  
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<sup>9</sup> Release at 66201.

<sup>10</sup> *See id.*