Yuri & Irina Starostenko

FAO **Mr.** Thomas Schneider, Chairman Of The Board Of Directors
COPY **Ms.** Kathrin Schneider, Member administration
Basellandschaftliche Kantonalbank

VIA EMAIL
17th April 2019

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Dear Sir,

Re: Yuri Starostenko et al. vs. UBS AG

On 6th March 2013, you, as a Licensed Audit Expert and statutory auditor, have signed a Report (the "Report") of the statutory auditor on the financial statements of UBS AG, which comprise the balance sheet, income statement and notes on pages 510 to 531 of the UBS AG's annual report (Form 20-F) for the year ended 31st December 2013, filed with the U.S. Securities and Exchange Commission (SEC) on 14th April 2014.

The Foreign Corrupt Practices Act of 1977 (FCPA), 15 U.S. Code §§ 78dd-1, et seq. requires companies whose securities are listed in the United States to meet its accounting provisions and prohibit off-the-books accounting. Although these accounting provisions were designed to operate in tandem with the anti-bribery provisions, they do not apply only to bribery-related violations.

Section 13(b)(2)(B) of the Exchange Act (15 U.S.C. § 78m(b)(2)(B)), commonly called the "internal controls" provision, requires issuers to devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that (i) transactions are executed in accordance with management's general or specific authorization; (ii) transactions are recorded as necessary (a) to permit preparation of financial statements in conformity with generally accepted accounting principles or any other criteria applicable to such statements, and (b) to maintain accountability for assets; (iii) access to assets is permitted only in accordance with management's general or specific authorization; and (iv) the recorded accountability for assets is compared with the existing assets at reasonable intervals and appropriate action is taken with respect to any differences.

2008 - 2011 Control Breakdowns

On 15th September 2011, UBS announced it had incurred a total loss of US$2.3 billion as a result of trading on the Exchange Traded Funds (ETF) desk in the Global Synthetic Equities (GSE) trading of the Investment Bank business division conducted from the London Branch.

In November 2012, UBS released a Report "Trading incident — September 2011" which states, among other things, that:

UBS expanded the responsibilities of its Chief Operating Officers beyond business-area planning to include overseeing controls across all functions for the entire lifecycle of a trade, from origination to final settlement and reporting.

UBS moved all Operations functions, including from the Investment bank, to the Corporate Center.

UBS accelerated the enhancements to the Operational Risk Framework to ensure that operational risks are assessed on a quarterly basis and supported by evidence.

UBS announced in November 2011 that it will exit all proprietary trading in the Investment Bank.

On 21st November 2012, Swiss Financial Market Supervisory Authority (FINMA) published Summary Report which states, among other things: 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.

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

"13.3. Fictitious ETF trades with deferred settlement dates: these trades, which were cancelled before reaching settlement, generated fictitious risk exposure and P&L. ... 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."

"(17) ... UBS did not have any formal policy covering the allocation and delegation of SCP C/A/L [cancelled, amended and late booked] trade alerts among supervisors.

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(18) UBS also lacked a clear policy describing Front Office supervisors' responsibilities in respect of reviewing and signing off SCP C/A/L alerts.

(19) Traders were able to influence their reported P&L to compensate for trade booking errors, trade capturing timing differences and delayed pricing. ... 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.

(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."

"(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."

"(34) 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.

(35) Operations focused on clearing reconciliation breaks; insufficient emphasis was placed on understanding the causes of breaks, or how they were resolved."

"(38) Controls over P&L adjustments were inadequate (see paragraph (19)). UBS had no policy on escalating P&L adjustments:

(39) The GBSOV [Global Balance Sheet Ownership and Verification] process proved to be ineffective. ... 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."

"(42) In 2008, the Operational Risk unit reviewed the risk of a rogue trading event occurring within UBS. ... 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 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.

(43) UBS failed to formalise and appropriately communicate the Desk's reporting lines and risk limits.

(44) ... 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."

"(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."

"(48) Senior management's emphasis on increasing efficiency compromised the effectiveness of certain controls."

"(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."

"(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."

On 26th November 2012, the Financial Services Authority (FSA) published News Release 105 which states, among other things: the FSA has fined UBS AG for systems and controls failings, which revealed serious weaknesses in the firm's procedures, management systems and internal controls.

"The FSA believes that UBS failed to take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems and failed to conduct its business from the London Branch with due skill, care and diligence."

"Tracey McDermott, director of enforcement and financial crime, said: "UBS's systems and controls were seriously defective.""

"During its investigations the FSA also took into account that in November 2009 UBS was fined £8 million for failings in relation to the systems and controls around the international wealth management business conducted with non-UK resident clients in the London branch of UBS. "

"UBS breached FSA Principles 2 (due skill, care and diligence) and 3 (risk management systems and controls) of the FSA's Principles for Businesses."

On 19th December 2012, Swiss Financial Market Supervisory Authority (FINMA) published Summary Report UBS LIBOR which states, among other things:

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> *"Substantial failings in the system and control processes for LIBOR submissions prevented those responsible at UBS from detecting and acting on the aforementioned occurrences. Internal guidelines, if they existed at all, were either deficient or not properly implemented."*
>
> *"FINMA admonishes UBS for severe violation of the organisational and the proper business conduct requirements under Swiss financial markets laws."*

On 19th December 2012, the Financial Services Authority (FSA) published News Release 116 which states, among other things: UBS AG fined for significant failings in relation to the London Interbank Offered Rate (LIBOR) and the Euro Interbank Offered Rate (EURIBOR).

> *"Between 1 January 2005 to 31 December 2010 the misconduct included, inter alia, corrupt brokerage payments [were made] to reward brokers for their efforts to manipulate the LIBOR submissions of panel banks."*
>
> *"Tracey McDermott, FSA director of enforcement and financial crime, said: "UBS's misconduct was all the more serious because of the orchestrated attempts to manipulate the JPY LIBOR submissions of other banks as well as its own and the collusion with interdealer brokers and other panel banks in coordinated efforts to manipulate the fix.""*

On 1st May 2014, The Financial Conduct Authority (FCA) published News Release 52 which, among other things, states:

> *"Part of the unauthorised trading involved creating and using an undeclared fund of profits, termed the "Umbrella", which had the effect of manipulating the Desk's reported profit and loss."*

2013 Control breakdowns

On 20th December 2013, Irina Tsareva-Starostenko, sent an email timed at 15:54 to the office of Group Chief Executive Officer with the information of a misconduct in ETF trading by Execution Desk in The Bahamas on a behalf of Junkanoo Estates Ltd. in which numerous employees and senior managers of the Nassau Branch and UBS Capital Markets L.P were involved between 12th June to 18th September 2013.

On the evidence received in separate proceedings of the Supreme Court of the Bahamas (see copy of Fifth Affidavit of renate Raeber filed on 7st March 2019 attached herein), UBS failed to produce the documents referred to in Regulation 72 of the Securities Industry Regulations of the Bahamas, 2012 (SIR 2012) as *"contract notes"* relating to transactions of sale or purchase of securities carried out by the Nassau Branch on behalf of Junkanoo Estates Ltd., which are also called *"execution reports"* in *"the regulatory instruments of the applicable marketplace"* within the meaning of Regulation 77 of the SIR 2012, which are the Rules of

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the New York Stock Exchange adopted by 22nd June 2010 (NYSE-2010-46), in particular Rule 123(f), which provides for the details of each execution report.

The evidence attests to the fact that UBS or its trading partners did not issue confirmations for the said ETF trades in 2013, acting in the same ways which have allowed trader Mawuli Adoboli of the London Branch to escape the detection of risk-control systems in 2008 to 2011. So, if UBS didn't send out trade confirmations in 2013 as a matter of course or didn't chase confirmations from its trading partners, the opportunity may have presented itself for false records to be created in the bank's systems in the course of an off-the-book accounting notwithstanding that the both regulators found in 2012 that UBS' risk management systems and controls were not fit for purpose, creating an environment in which dangerously large off-the-book positions could be concealed.

The evidence attesting that organisational measures (the "UTIR Programme") implemented across the UBS group led by a special Group Executive Board task force, chaired by Group COO Ulrich Körner and overseen by our Board of Directors, and the post-incident reviews carried out by KPMG, failed to assure the fit and proper conduct of its business operations and ensure that identified control deficiencies were in fact sustainably remediated.

FCPA Risk

The UBS' top management had sufficient knowledge of the misconduct in ETF trading by Execution Desk in The Bahamas, while UBS should have been able to exercise the same level of control over the Nassau Branch and to cause it to devise and maintain a system of internal accounting controls consistent with UBS' own obligations under the FCPA.

On the evidence, material systemic procedures, management systems and internal controls failures of UBS, identified by the Swiss and UK regulators in 2012, persisted for a significant and continuous period of time without correction, being unable to ensure transparency in the financial health of the business and the transactions between the bank and its customers and business partners, the accuracy of the corporate books and records and the reliability of the audit process which constitute the foundations of the U.S. system of corporate disclosure.

Both the Nassau Branch and UBS Capital Markets L.P, subsidiaries that were not listed in the Form 20-F, however contributed to the UBS Group's total assets and the corporation's transactions, to the effect that there is a risk that the consolidated financial statements which are comprised of the consolidated balance sheets as of 31st December 2013, and the related consolidated income statements and consolidated statements of comprehensive income, changes in equity and cash flows, and notes, pages 350 to 505 of the Form 20-F, did not present fairly in all material respects, the financial position of UBS AG and its subsidiaries in case if it failed to reflect the realities of the true position at 31st December 2013 as regards the use of undeclared off-the-books funds and accounts, thereby causing the Investment Bank's Investor Client Services business unit's and some of UBS' subsidiaries listed in the

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Form 20-F such as, for example, UBS Securities LLC's, a registered broker-dealer, through which UBS conducted securities activities in the U.S., and UBS Americas, Inc.'s books and records to be inaccurate.

Section 10A of the Exchange Act, 15U.S.C. § 78j-1, requires auditors who become aware of illegal acts to report such acts to appropriate levels within the company and, if the company fails to take appropriate action, to notify SEC.

Additionally, the auditor must communicate all significant deficiencies and material weaknesses identified during the audit to management and the audit committee taking in account that an issuer's responsibility extends to ensuring that subsidiaries or affiliates under its control comply with the accounting provisions.

Under a New York Stock Exchange (the "Exchange") Listing Agreement for Foreign Private Issuer, UBS AG, as the Applicant Issuer certified that it understands and agrees to comply with all current and future rules, listing standards, procedures and policies of the Exchange and all requirements under the federal securities laws and applicable SEC rules.

With the present, for the purpose to ascertain your knowing state of mind with respect to conduct of the UBS Corporate Center, the UBS Investment Bank, UBS Americas, Inc., UBS Capital Markets L.P, UBS Securities LLC, UBS (Bahamas) Ltd. in ETF trading by Execution Desk in The Bahamas on a behalf of Junkanoo Estates Ltd. between 12th June to 18th September 2013, I hereby request you to be aware that the mentioned above entities were engaged in the said trading and failed to comply with NYSE Dealings and Settlements (Rules 45—299C), adopted: June 22, 2010 (NYSE-2010-46), as amended: September 28, 2015 (NYSE-2015-27), in particular failing, among other things, to produce details of order execution reports with respect to trades, executed during the above period on behalf of Junkanoo Estates Ltd., which must be entered into the same database as required by Rule 123 for the entry of orders using a proprietary system to record the details of an order pursuant to paragraph (e) being capable of transmitting a report of the order's execution to such database.

Also, I respectfully request you to discharge your statutory duties under section 10A of the Exchange Act, 15U.S.C. § 78j-1.

In the meantime, I remain yours faithfully,

Yuri Starostenko

Director, Junkanoo Estates Ltd.

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