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MARKETS

UBS Faces Client Backlash Over Options Strategy

Program suffered in last year's market volatility

By Gretchen Morgenson

Aug. 23, 2019 5:30 am ET

A complex investment strategy pitched as low-risk by stockbrokers at UBS Group AG UBS **1.53%** ▲ has triggered a backlash from clients of its securities unit.

The strategy, called Yield Enhancement Strategy, or YES, has generated at least $60 million in losses for clients and more than two dozen customer complaints, according to a lawyer for the investors.

The strategy involved the use of several option trades and borrowing, according to marketing materials, and faltered when volatility in the stock and bond markets intensified last year. In just one month late last year, the strategy had losses exceeding 13%, a customer-account statement indicates.

The UBS team overseeing YES had $5 billion to $6 billion in assets under management, arbitration records show.

A UBS spokesman said the benefits and risks of the strategy were clearly disclosed to investors.

"Clients who participated in the strategy acknowledged in writing that significant market movements could result in losses and that they should not participate in the strategy unless they were prepared for the potential of large losses," he said in a statement. The spokesman added that only a small percentage of customers who invested in the program have filed arbitration claims over it.

UBS marketing materials state the program seeks to limit exposure to extreme market moves.

Two UBS portfolio managers oversaw the YES Group and began promoting the strategy to other sales representatives across the firm in 2015, arbitration records show. Through the UBS spokesman, the brokers declined to comment.

The strategy's losses highlight the risks in financial bets during periods of heightened volatility in the markets. The YES strategy typically involved putting on four different options trades—relating to an underlying stock index, such as the S&P 500—at different strike prices but with the same expiration date. The strike price can be the point at which the owner of a "call" option can buy or the owner of a "put" option can sell the underlying security.

The sale of short-term, "out-of-the-money" puts and calls on an index—a situation when the underlying price of the index isn't at or better than the option's strike price—was coupled with the purchase of short-term below-market puts and above-market calls on the index to mitigate risk, UBS marketing materials show.

When the S&P 500 was relatively stable, for example, the options generated a positive return, but when the index gyrated, losses resulted. Because the strategy made use of borrowed funds —as much as $5 were borrowed and invested for every dollar put in by the client—investors had to either put up additional money or have their positions sold at a loss when the trades went against them.

Ms. Pellini in her apartment in Stamford, Conn. PHOTO: JULIE BIDWELL PHOTOGRAPHY FOR THE WALL STREET JOURNAL

Sherrie Pellini, who supports three children and a mother and has little investment experience, put $3 million into the YES program in March 2017. She has filed an arbitration case against UBS contending that her broker didn't advise her of the risks in the investment. She says she lost $750,000.

Ms. Pellini, 60 years old, and several other UBS clients said their brokers told them the investment strategy had a lengthy and solid record. Ms. Pellini said her broker, Robert Perlman, told her the strategy had a 17-year history of no losses. “He said: ‘If the world came to an end tomorrow, you’d be the only one with any money left,’” Ms. Pellini recalled.

Asked about this exchange, UBS declined to make Mr. Perlman available for a comment.

When selling the enhancement strategy, UBS brokers focused on the firm’s wealthy clients. The firm’s spokesman confirmed that it offered the program to clients whose net worth was at least $5 million, not an unusual threshold for complex or highly leveraged investments.

Ms. Pellini was charged 1.75% to invest, according to Jacob Zamansky, a securities lawyer in New York representing Ms. Pellini and other UBS customers. Fees exceeding 1% for wealthy investors are generally considered steep.

The UBS spokesman declined to disclose the commissions the program generated for the firm’s brokers.

Over the past decade, regulators have cited UBS for securities-law violations at least nine times, Securities and Exchange Commission filings show. Many matters involved individual investors who had been harmed when they bought specialized and complex UBS products. In all cases, UBS settled with regulators, neither admitting nor denying the allegations.

A UBS spokesman declined to comment on the regulatory actions.

Data compiled by the Securities Arbitration Commentator, a periodical focusing on trends in commodities and securities arbitration, show that among clients of the top brokerage firms, clients of UBS have had the highest win rate in their decided cases in recent years.

In 2015, for example, UBS’s customers prevailed against the firm in half of cases heard. That figure rose to 52% in 2016 and 58% in 2017, the most recent figures for which data are available.

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