INITIAL DECISION RELEASE NO. 513
ADMINISTRATIVE PROCEEDING
FILE NO. 3-14862

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

In the Matter of	:	
	:	INITIAL DECISION
MIGUEL A. FERRER, and	:	October 29, 2013
CARLOS J. ORTIZ	:	
	:	

APPEARANCES: Robert K. Levenson and Edward D. McCutcheon for the Division of Enforcement, Securities and Exchange Commission

Melvin A. Brosterman, Francis C. Healy, David M. Cheifetz, Stephanie A. Cournoyer, and Patrick N. Petrocelli for Miguel A. Ferrer

Peter J. MacDonald, Peter G. Neiman, Fraser L. Hunter, Jr., Brad E. Konstandt, Meghan D. Rohan, J. David Zetlin-Jones, and Clarion E. Johnson for Carlos J. Ortiz

Guillermo J. Bobonis, local counsel for Mr. Ferrer and Mr. Ortiz

BEFORE: Brenda P. Murray, Chief Administrative Law Judge

The Securities and Exchange Commission (Commission) issued an Order Instituting Administrative and Cease-and-Desist Proceedings (OIP) on May 1, 2012, pursuant to Section 8A of the Securities Act of 1933 (Securities Act), Sections 15(b) and 21C of the Securities Exchange Act of 1934 (Exchange Act), and Section 9(b) of the Investment Company Act of 1940 (Investment Company Act). In summary, the OIP alleges that in 2008 and 2009 (relevant period), Miguel A. Ferrer (Ferrer) and Carlos Juan Ortiz-Leon (Ortiz) made misrepresentations and omitted material information about closed-end funds whose shares were issued and sold to investors by UBS Financial Services Inc. of Puerto Rico (UBS PR).

I held 13 days of hearing that resulted in a record of 3,178 pages of testimony from 29 witnesses and 536 exhibits: 177 from the Division of Enforcement (Division), 164 from Ferrer, and 195 from Ortiz.[1] The post-hearing briefing, totaling 838 pages, ended March 15, 2013.

Issue

This case is unusual. The facts are undisputed and the witnesses were for the most part forthcoming and credible. The issue is a serious difference of opinion about the level of information required to be provided to investors about a policy decision by the parent company and whether Ferrer's and Ortiz's actions in response to that policy decision violated the antifraud provisions of the securities statutes.

Findings of Fact

The findings and conclusions herein are based on the entire record. I applied preponderance of the evidence as the standard of proof. See Steadman v. SEC, 450 U.S. 91, 102 (1981). I have considered and rejected all arguments and proposed findings and conclusions that are inconsistent with this Initial Decision.

UBS PR

UBS PR is a registered broker-dealer and the largest in the Commonwealth of Puerto Rico (Puerto Rico) with from 47% to 51% of the market in assets under management (AUM).[2] Tr. 19, 31-32, 207-08; Div. Ex. 21 at Bates 0120. UBS PR's parent company is UBS Financial Services, Inc. (UBS or parent company), a Delaware corporation with principal places of business in New York, New York, and Weehawken, New Jersey (Weehawken), that is a wholly owned subsidiary of UBS, AG, a private issuer based in Switzerland. Tr. 20.

In 2008-2009, UBS PR was operated by persons in Puerto Rico, but Legal, Compliance, and Market Risk were handled by persons in Weehawken. Tr. 190-91. UBS PR operated as a region of UBS, but for tax purposes it maintained a separate corporate structure. Tr. 1291. The actions of UBS's Market Risk Control Committee or Risk Committee Wealth Management Americas (Risk Committee), chaired by UBS's Chief Financial Officer (CFO), located in Weehawken, were crucial to the events at issue.[3] The Risk Committee set the level of UBS's

---

[1] I will cite to the transcript of the hearing as "(Tr. __.)." I will cite to the Division's and Respondents' exhibits as "(Div. Ex. __.)", "(Ferrer Ex. __.)", or "(Ortiz Ex. __.)". I will use similar designations in citations to the post-hearing filings.

[2] UBS PR's nearest competitor in Puerto Rico has about 20% of the market. Tr. 210. Ortiz estimates UBS PR's market share at 50% to 60%. Tr. 782.

[3] Wealth Management Americas is one of three business divisions of UBS, AG and its subsidiaries. Wealth Management Americas operates a core business line and includes the domestic U.S. business, domestic Canadian business, and the international business booked in the U.S. Wealth Management Americas consists of branch networks in the U.S., Puerto Rico, and

worldwide risk exposure and thus determined the amount of inventory UBS PR could hold. Tr. 645, 976. Persons delivering Risk Committee decisions to UBS PR included Bernd Michel (Michel), UBS Chief Risk Officer, Mark Guarino, Director UBS Credit Risk Control, Jim Hausmann (Hausmann), head of traditional products for Wealth Management Americas, and Thomas Magdziak (Magdziak), UBS's Market Risk Officer, and Michael Culnan (Culnan), who replaced Magdziak in April 2009. Tr. 126, 476, 643, 812, 1159, 2161. No one from UBS PR was on the Risk Committee. Tr. 1292, 2648.

Ferrer

Ferrer holds B.A. and M.B.A. degrees from Cornell University. Tr. 1289. He entered the securities industry in 1961 as a financial advisor (FA). Tr. 1289. Ferrer is responsible for UBS PR's preeminent position in the Puerto Rican securities market. In 1965, he opened a two-person office in Puerto Rico for Blyth, Eastman, Dillon, which is today UBS PR. Tr. 1290. In 1986, under his leadership, UBS PR began tailoring financial products to Puerto Rican investors when other broker-dealers relied on their standard products. Tr. 209-10. In 2005, UBS PR was recognized by UBS for its focus on clients. Tr. 1396-98; Ferrer Ex. 534. Ferrer did not consider that good enough. Tr. 1398. Ferrer was Chairman and Chief Executive Officer (CEO) of UBS PR from 2003 until October 2009. Three months later he was re-hired as Vice-Chairman. Tr. 991; Div. Ex. 152 at 1.

Ferrer is considered a financial visionary with respect to Puerto Rico. Tr. 2172, 2904. Alfredo Salazar, who has been: (1) President of the Puerto Rico Industrial Development Company; (2) President of the Government Development Bank of Puerto Rico (GDB), which manages the debt of the central government and advises the Governor of Puerto Rico; (3) President of Chase Manhattan banks in Brazil and Argentina; (4) a position with Paine Webber; (5) President of Banco de Ponce; (6) head of the Economic Development Administration in Puerto Rico; (7) President of Palmas Del Mar Properties; and (8) Chairman of the Board and then, again, President of the GDB, testified that Ferrer is a close advisor on financial matters and they have a relationship of mutual respect. Tr. 2163-73.

Carlos Ubinas (Ubinas), President and Chief Operating Officer of UBS PR, hired Ferrer and is the only person who reported to Ferrer.[4] Tr. 169, 211, 1048, 1299, 2904. Ferrer reported to James D. Price (Price), Chairman of UBS PR, in Weehawken, who reported to Marten Hoekstra (Hoekstra), head of Wealth Management of Americas. Tr. 214, 809, 992, 1159, 2492-95. Hoekstra and Price were on the Risk Committee. In 2008 and in 2009, Ferrer was also CEO

Canada. http://www.fdic.gov/regulations/reform/resplans/plans/ubs-1207.pdf (last visited Oct. 18, 2013).

[4] Ubinas is a graduate of George Washington University and the University of Puerto Rico School of Law. Tr. 2827. Before joining UBS PR in 1990, he worked at a law firm in Puerto Rico and as a Vice-President, GDB. Tr. 2827-29.

of UBS Trust Company, and CEO and Chairman of each of the Funds.[5] Tr. 991, 1113; Ferrer Ex. 525. Ferrer was paid $300,000 in salary and a $150,000 cash bonus, for 2008, and his total compensation in 2008 and 2009, was over $2.5 million and $2 million, respectively.[6] Tr. 1267-71; Div. Exs. 90, 122.

Ferrer communicated with Financial Advisors (FAs) regularly and had a reputation for trying to energize the sales force by sending memos and e-mail messages with his strong beliefs in UBS PR products. Tr. 2801-03. He considered keeping FAs focused a very important CEO function. Tr. 1494. Ferrer testified he had no direct responsibility for sales, but an FA testified that Ferrer came to his branch sales presentations about twice a year and told FAs to recommend investments. Tr. 1628-30, 1632. Ferrer acknowledged that he wished his e-mails and memos to FAs resulted in sales conversations, but denied it was their main purpose. Tr. 1494-95.

Ferrer contacted the Trading Desk on behalf of FAs who came to him with complaints. Tr. 1138-41, 1286; Div. Ex. 5. Ferrer played no role in pricing or setting inventory levels, and he is not an expert in trading. Tr. 221, 1084, 1156, 1352-53, 2905-06. Ferrer did not consider that he had any responsibility in formulating disclosures to FAs or to customers, and he testified that Legal and Compliance determined what disclosures were required of UBS PR. Tr. 1357-58, 1485.

FAs and Eugenio S. Belaval (Belaval), head of UBS PR Wealth Management, kept Ferrer informed about markets and prices.[7] Tr. 15, 1287. In 2008, FAs told Ferrer that the market was imbalanced, and in 2008-2009, FAs complained to him about trouble selling shares. Tr. 1028. Ferrer knew in May 2009 that UBS had ordered UBS PR to reduce inventory, and that the Trading Desk had stopped buying shares and was lowering prices to sell inventory. Tr. 1242-43, 1248.

<u>Ortiz</u>

Ortiz is a graduate of Georgetown University and the Wharton School, University of Pennsylvania, in 1985. Tr. 495. He joined First Boston Corporation in Puerto Rico in 1985 as an associate specializing in investment banking and became a Vice-President. Tr. 495-97. The parent company of Banco Popular acquired First Boston's Puerto Rican operations in 1994. Tr.

---

[5] UBS Trust Company, an affiliate of UBS PR, is organized under the laws of Puerto Rico. Div. Ex. 21 at Bates 0120. It is not a registered investment adviser. Div. Ex. 124 at Bates 2381. A division of UBS Trust Company, UBS Asset Managers of Puerto Rico (Asset Management), manages each Fund's portfolio. Tr. 2670-74, 2715-16.

[6] The largest compensation component related to the profitability of UBS PR, UBS, and UBS AG, and was a subjective management decision. Tr. 1268, 1272. Ferrer testified that because the firm was not profitable, he received less than a third of these amounts. Tr. 1267-71.

[7] Belaval headed one of three groups that reported to reported Ubinas. Tr. 211; Div. Ex. 3, Ferrer Ex. 525. The others were Investment Banking and Asset Management. Tr. 2830-31.

497-98. Ubinas and Belaval convinced Ortiz to join UBS PR from Banco Popular on June 2, 2003, as Managing Director and head of the Capital Markets Division. Tr. 272, 498-500. Ortiz and Ubinas knew each other as investment bankers before either joined UBS PR. Tr. 587, 2832-83. Ortiz is a well-respected member of the Puerto Rican community.[8]

Ortiz was in charge of the Capital Markets Trading Desk and responsible for: (1) UBS's initial public offerings (IPO) of municipal securities involving syndicate operations and closed-end funds; (2) secondary trading of UBS securities; and (3) financing municipal paper through repurchase agreements.[9] Tr. 15-24, 159, 161, 499; Div. Ex. 22 at Bates 1251. Open-ended funds can be redeemed through the issuer at net asset value (NAV). Tr. 2281-82. Closed-end funds are not redeemable at NAV but are sold through exchanges or over-the-counter from a dealer at a price that is agreeable to buyer and seller that may be equal to, greater than, or less than, their per share NAV.[10] Tr. 2282-83; Ortiz. Ex. 201 at 7. Dealers, such as UBS PR, typically maintain an inventory of closed-end fund shares. Tr. 2283.

Ortiz was responsible for daily closed-end fund pricing and trading decisions and he supervised eight people. Tr. 25, 273, 856, 866. Ortiz and the Trading Desk dealt with the sales force, they did not deal with customers.[11] Tr. 164-66, 479-80, 500. Ortiz attended meetings of FAs and provided information to assist them in marketing, and he sent persons from the Trading Desk to other sales meetings. Tr. 422-24, 929-32; Div. Exs. 62, 150. Ortiz was not responsible for supervising FAs, preparing Fund marketing materials, or determining what disclosures the Funds should make to clients. Tr. 2835.

FAs could decide whether to charge 1%, 2%, or 3% commission on the Fund price. Tr. 1592-93. Three percent was a high commission in the Puerto Rico fixed income market. Tr. 2031-32. The Trading Desk had a 0.5% spread and the FA received the rest. Tr. 859. On a $10 per share price, for example, the Trading Desk received $0.05. Tr. 908.

Ortiz reported to Belaval and Belaval was responsible for: (1) retail sales; (2) disclosing material information about UBS PR closed-end funds to investors; and (3) making sure that FAs

[8] Carmen Vega, who in 1993 founded El Museo de Nino de Puerto Rico, a children's museum modeled after the Boston Children's Museum, spoke appreciatively of Ortiz's hands-on efforts from 1989 through about 2008, to open the museum and his leadership as a member and then President of the Board of Directors. Tr. 2152-60.

[9] Ortiz occupied the same position in 2012. Tr. 173. In the IPO phase, the Trading Desk built the book of orders and then underwrote the deal. Ferrer viewed trading of the closed-end funds as an activity to support the firm's products, not as a profit center. Tr. 1235.

[10] NAV "is calculated by dividing the total market value of the fund's assets, minus its liabilities, by the number of mutual fund shares outstanding." Ortiz Ex. 201 at 7, n.1.

[11] An exception would be where a client wanted to sell closed-end fund shares in amounts over $5 million. Tr. 163-64.

and Client Service Associates (CSAs) made appropriate disclosures to clients.[12] Tr. 520, 2835. Ortiz had a good reputation inside the firm. Tr. 2606.

UBS PR's 23 closed-end funds

During the relevant period there were 23 closed-end funds (Fund(s)). Tr. 18, 27, 31, 993; Div. Ex. 153 at 6. Seven funds, begun between 1995 and 1999, were co-sponsored with Banco Popular, and 16 funds begun between 2001 and 2008 were sponsored solely by UBS PR. Tr. 29-30; Ortiz Ex. 201 at 10. The Funds' stated objectives are to provide current income consistent with the preservation of capital. Div. Ex. 152 at 7. According to Ferrer, the Funds were created to give Puerto Rican investors an opportunity to invest regularly in domestic investments. Tr. 1118-19. The Funds are in the UBS Trust Company and UBS PR is the broker-dealer for trading Fund shares. Tr. 1113.

The Funds are not registered under the Investment Company Act.[13] Div. Ex. 152 at 6. The Funds are organized under Puerto Rican law, with the Commissioner of Financial Institutions' approval, that requires 67% of Fund assets to be invested in Puerto Rico, and allows the Funds to borrow one dollar for every dollar of capital.[14] Tr. 27-28, 30; Div. Ex. 22 at 88. The result is that the Funds' assets consist of at least 67% Puerto Rican assets and 33% U.S. assets most of which is invested in agency paper, primarily fixed rate long-term securities. Tr. 28-29, 202, 2676-77, 2742. This allows shareholders to own 33% United States government paper, which would be taxable to United States citizens residing outside Puerto Rico, but, owning through the Funds, provides tax-exempt income to Puerto Rico residents. Tr. 2592.

Using leverage, the Funds are able to hold twice the amount of assets as the amount of equity. Interest rates are significant to the Funds because they mainly use short-term financing and the difference between the return on assets and the cost of funding is the amount of dividends the Funds can pay. Tr. 284-85, 1496, 2742-43. The Funds are considered a pass-through entity, which under Puerto Rican law they distribute approximately 90% of their income. Tr. 2684-85. Asset Management Division (Asset Management) of UBS Trust Company, which managed the Funds had a policy of maintaining stability in Fund dividends. Tr. 2684-85. The low interest rates that existed from May through the Fall of 2008 caused many Fund asset managers to increase dividends as they bought assets at low prices and passed benefits on to investors. Tr. 611.

---

[12] Belaval supervised several business units, including Capital Markets, six Branch Office Managers (BOM), and Regional Sales Managers. Ferrer Ex. 525. In 2008-2009, Belaval was also President of UBS Trust. Tr. 186; Ferrer Ex. 525. Legal and Compliance determined what disclosures should be made to clients. Tr. 2835.

[13] The basis for the exemption appears to be a no-action letter. Tr. 2830.

[14] The example given is that for every dollar invested, a Fund can buy two dollars of securities with the second dollar of purchases financed with borrowed funds. Tr. 35-36.

In his position as UBS PR Chairman, Price was concerned:

> Because we run a very large business in Puerto Rico, have a significant market share with a finite, really a finite investor population, because of the tax laws and we essentially underwrite trade and manage, you know, all sides of the equation, it is, you know, fraught with potential conflict and risk of doing that and I think we disclosed those risks exceptionally well, but they're there. So I've always had a view that the people we have down there running the business actually do it exceptionally well and know the marketplace and then our disclosures and our policies and the independent nature of our board on the funds themselves and our governance process manage those risks pretty well, but it doesn't mean I don't think about it.

Tr. 2498-99. Price testified that his reference to a very large business was not just to the Funds because UBS PR ran a retail business, an investment banking business, and an asset management business. Tr. 2500.

A 2009 brochure identified 13 closed-end funds as UBS Family of Funds and 9 closed-end funds as Puerto Rico Investors Family of Funds.[15] Div. Ex. 10. Six Funds had 90%-95% AAA credit quality instruments and 16 held 80%-95% investment grade quality instruments. Ferrer Ex. 543 at 4. The majority of Funds are referred to as the BBB Funds. Tr. 1425. Each Fund has the same Board, except for 2 that had 2 additional members. Tr. 1426. The 11 member Board has 7 independent directors. Tr. 1426, 2688. In 2007-2009, individual Fund assets ranged from $25 to $500 million. Div. Ex. 152 at 8. According to Ricardo Ramos (Ramos), a managing director in Asset Management, the Funds had $9 billion to $10 billion in AUM in 2008-2009.[16] Tr. 2673. On November 30, 2011, the breakdown is roughly $5.8 billion in capital and $5 billion in leverage. Tr. 2673-74.

The Funds began with an IPO by UBS PR. Individual Funds might have similar objectives, but all have different portfolios. Tr. 1300-01. UBS PR depends on retail customers to generate demand for all the securities it issues. Tr. 93. A Fund prospectus was furnished to purchasers in the IPO, but not to purchasers in the secondary market. Tr. 1107.

The Funds do not do a lot of buying and selling, the portfolio manager's strategy is to maximize the spread between the income on assets and the cost of financing those assets. Tr. 2680. Two major advantages for Fund investors are that United States citizens residing in Puerto Rico for 181 days a year do not pay taxes on Puerto Rico source income, and Puerto Rico citizens do not pay inheritance tax on Puerto Rico assets such as Fund shares. Tr. 202-05, 1296-

[15] There are two Family of Funds brochures in evidence. The 2008 brochure is Div. Ex. 11 and is also part of Div. Ex. 123. The 2009 brochure is Div. Ex. 10. Tr. 1773-74.

[16] Ramos graduated from the Wharton School, University of Pennsylvania in 1977, with a degree in Finance and earned an M.B.A. from the University of Chicago, Booth School of Business. Tr. 2667-68.

97, 1562-63. The Funds are only sold in Puerto Rico, almost exclusively to individuals. Tr. 628-29. The average age of a Fund investor is 60. Tr. 137.

The Funds represent about one-third of UBS PR's AUM. Tr. 43. In 2008, Fund revenues were $94.5 million. Tr. 1136; Div. Ex. 23 at Bates 11116. In the years 2004 through 2008, from 42% to 53% of UBS PR's revenues were earned from the Funds. Tr. 41, 2496-97; Div. Ex. 23 at Bates 011232. In 2008 through 2009, UBS PR had approximately $12 billion in AUM, with about $3.5 billion in the Funds and $6.5 to $7 billion in municipal paper. Tr. 26-27, 208. About 90% of UBS PR customers invest in fixed-income securities, primarily municipal bonds and bond related closed-end funds. Tr. 26. The Funds became eligible as an IRA investment in early 2009. Tr. 1180; Div. Ex. 124.

In 2008-2009, UBS PR's retail operations headquartered in Hato Rey, Puerto Rico, had about 400 employees including 140 FAs, 5 branch offices, and approximately 14,000 customer accounts for approximately 10,000 households. Tr. 15, 91, 182, 994. FAs work in teams and some teams have $3 billion, $1.5 billion, or $800 million of AUM. Tr. 1379. Ferrer makes the point that to keep clients it is necessary to provide good advice, and in 2008-2009, many FAs advised clients not to sell in the panic situation that existed and they forego commissions by doing so. Tr. 1378-81. Ferrer communicated with an FA group called "Chairmans," recognized for professional achievement in terms of AUM or revenues generated. Tr. 1114; Div. Ex. 72

Customers must have an FA, they cannot place trades directly. Tr. 519. Ferrer testified that FAs or wealth advisors are UBS PR employees who are top professional executives who advise clients as opposed to salesmen. Tr. 1377-82, 1422-23. "[T]hey put together a recommendation for clients on how to build a portfolio of investments that will take them to whatever goal they seek. It is much more than just selling." Tr. 1378. As part of their training, FAs are told they must inform clients that Fund shares experience periods of illiquidity, i.e., when a customer is unable to sell shares within a short period of time. Tr. 121, 186, 893, 1327. The Commission defines securities as illiquid if they cannot typically be sold within 7 days at a price close to their fair value. Div. Ex. 152 at 4.

UBS PR customers like to buy new funds and FAs tend to concentrate on new products, so an IPO for a new fund or a new municipal bond offering could slow down purchases of Fund shares in the secondary market temporarily. Tr. 100-04, 367, 371, 904-05. UBS PR charges a 4.5% or 4.75% sales charge on IPO shares, 3.5% of which goes to the FA, and a 3% sales charge on secondary sales. Tr. 106, 1125-28. The Funds charge a 1% operating expense. Tr. 1127. Typically, customers were retirees who relied on income from the Funds. Tr. 1561-62.

When UBS PR talks about giving information to the market, it means providing information to FAs. Tr. 531-32. CSAs assisted FAs. Tr. 700, 984. BOMs and FAs dealt with clients and submitted all customer orders. Tr. 164-65, 479. The sales force was capable of selling $50 to $100 million worth of Fund shares in a month with little effort. Tr. 626-27. The sales force was capable of raising $50 to $75 or $80 million in sales of a new issue and also selling from $30 to $50 million of Fund shares in the secondary market. Tr. 627. During the relevant period, FAs became upset with the Trading Desk about the lack of firm bids and the time it took to execute transactions. Tr. 91-92. A firm bid is an executable price the Trading Desk was willing to pay for a specified number of shares. Tr. 291.

When an FA placed an order, it was recorded in the order book and gained a priority in the trading activity. The types of orders were market orders, limit orders, day orders, and good-til-canceled (GTC) orders.[17] Tr. 74, 304. Market orders, i.e., the client would accept the market price, were treated as priority orders and always filled first. Tr. 74, 468, 530, 864-65. Most orders were limit orders, meaning the customer specifies the conditions of sale or purchase such as price, partial, all or none, etc. Tr. 281, 863. A day order expires at the end of the day. Tr. 863-64.

GTC orders occurred when an FA had a client who wanted to sell shares at an executable price but the Trading Desk was not buying shares so the FA entered a GTC order. Tr. 73-75, 1636, 1716. The GTC list of all open marketable orders did not go to customers. Tr. 480. A customer's marketable or executable order to sell shares is at a price at or below UBS PR's bid price. Tr. 873-74, 899, 962, 1722-23. It appears that most, but not all, GTC orders were limit orders. Tr. 468, 958. Publishing the GTC book was to encourage FAs to engage in riskless principal trades when UBS PR had no risk appetite.[18] Tr. 1636-37; Div. Ex. 22 at Bates 1262. On May 8, 2009, 12 of the 23 Funds had open executable GTC sell orders. Tr. 317-23; Div. Ex. 59.

A market imbalance occurred when sellers exceeded buyers for Fund shares. Tr. 67-68, 93-94, 116, 151-52, 166-67. The Funds experienced market imbalances 3 or 4 times between 1995 and 2008, each lasted for several months and was self-correcting. Tr. 93-94, 116, 151-52, 166-67, 2913-14. Rising short-term interest rates caused market imbalances in 1999-2000 and 2004-2006. Tr. 2913-14. A significant imbalance occurred in 2006 when the government of Puerto Rico shutdown for about 2 weeks, but recovery was quick. Tr. 690, 1578-79. On May 15, 2006, Belaval and Ortiz sent a memo to Managers, Trading Desk personnel, Operations personnel, FAs, and Service Associates informing them that an increase in sales orders had, at times, resulted in more sellers than buyers and thus illiquidity. The memo stated in periods of illiquidity, it was important that the FAs and CSAs disclose to clients that there may be a delay in executing sales orders, the execution price may differ from the current price shown by the Trading Desk, and the Trading Desk may not reflect bids for certain Funds.[19] Tr. 180; 522; Ortiz Ex. 227.

---

[17] The evidence on the GTC book, basically a spreadsheet with all open orders, is confusing. Tr. 871; Div. Ex. 59. It appears that all GTC orders were retained until they were executed or canceled, but only marketable GTC orders were sent to the FAs. GTC orders were also referred to as marketable open orders. Tr. 563, 833-36. Rosado testified that from time to time the GTC book included marketable orders, and on very few occasions it included open market orders. Tr. 957-58.

[18] The formal name was the Funds Intraday Inventory Sheets/GTC Book.

[19] Belaval testified that the memo was to inform FAs of a new automated system for entering orders because FAs had complained about operations at the Trading Desk and it described the execution priorities. Tr. 123-24.

In 2008-2009, periods of market imbalance were much more difficult than in prior periods. Tr. 127, 152. Market imbalances endured longer and coincided with the bankruptcies of three Puerto Rican banks with $12 billion in investor losses, reductions in the Funds' NAV, budgetary problems of the Puerto Rican central government, and unfavorable publicity for a major bond offering.[20] Tr. 45-46, 64, 93-94.

UBS PR's most productive FA testified about the 2008-2009 market imbalance:

> [D]uring that timeframe it was a very rough patch for the financial industry, particularly in Puerto Rico. We had closing of three banks out of eight, compared to 189 banks in the States versus 9,200 banks. So the effect in particular was more devastating. We also had preferred share securities that went to zero, that went bust. A lot of conservation trust bonds went to zero.
>
> . . .
>
> And I do recall prices dropping, but I don't – I have no percentage to give you.

Tr. 2246.

From the summer of 2008 into January 2009, UBS PR did not send out a memo to FAs, and did not give notice to Fund shareholders or to potential investors as it did in 2006, that it faced market imbalance in the Fund shares. Tr. 121-22, 1576. According to Belaval, FAs would recognize that a market imbalance situation existed when the Trading Desk posted indicative rather than firm bids, and when sell orders took longer to execute.[21] Tr. 180, 227, 228. Ortiz testified that in late 2008, the Trading Desk used meetings and suggested talking points to inform the sales force of the market imbalance in certain Funds. Tr. 687-89; Ortiz Ex. 267. During 2008-2009, Ramiro Colon (Colon), a BOM, told the FAs that Fund inventory was growing and they needed to sell more. Tr. 1652. An FA in Colon's branch testified that no one at UBS PR told him that the Trading Desk was lowering prices below pending customer limit orders to reduce inventory. Tr. 1653. FAs were told that supply and demand were the reason for the decline in Fund share prices. Tr. 1653.

The general financial crisis in 2008 affected the markets for some Funds because it created uncertainty and thus more sellers than buyers, however, significant trading occurs even in periods of market imbalance. Tr. 129, 893-94. Each Fund reacted separately to events, so some Funds were out of balance at the same time as other Funds were in balance. Tr. 66, 416. It was necessary to look at the nature of the open limit orders to assess market conditions. Tr. 408-

[20] Each Funds' NAV, using fair market valuation, was determined weekly by an independent third-party. Tr. 2698-01, 2914-15. PriceWaterhouse Coopers has audited the Funds since their inception. Tr. 2671.

[21] Indicative bid is an eponymous term, i.e., an indication of what the Trading Desk believes the shares might be worth.

09. In June 2008, 2 new municipal bond offerings totaling $1 billion were announced – pension obligation bonds (POB) and Puerto Rico sales tax revenue bonds. Tr. 652; Ortiz Ex. 372. From May 2008 through January 16, 2009, the supply of Fund shares exceeded demand, many Funds had more sellers at prices at or below the UBS PR bid price, and sellers' orders were not executed. Tr. 352, 354-56, 405-07, 413, 416.

During 2008-2009, Fund Directors, including Ferrer, were provided information that:

1. For the quarter ending March 31, 2008, the 22 Funds that existed at the time all had positive returns, after taxes, assuming dividend reinvestment, every year. Tr. 1305-06; Ferrer Ex. 628 at 60. The lowest average annual return, after taxes, was 3.38% and the highest was 8.31%. Tr. 1305-06; Ferrer Ex. 628 at 60. Ranked against a universe of 188 funds, 14 of the Funds showed low price volatility over the preceding 5-year period. Tr. 1307; Ferrer Ex. 628 at 61.

2. For the quarter ending August 28, 2008, the 22 Funds that existed at the time all had positive returns, assuming dividend reinvestment, every year. The lowest average annual return, after taxes, was 3.83% and the highest was 8.34%. Ferrer Ex. 629 at 59. Ranked against a universe of 189 funds, 15 of the Funds showed low price volatility over the preceding 5-year period. Tr. 1317; Ferrer Ex. 629 at 60. Dividends went up and all Funds traded above NAV. Tr. 1316; Ferrer Ex. 629 at 9.

3. For the quarter ended November 14, 2008, the annual average market performance with reinvestments for the 22 Funds was between 4.88% and 8.39%. Ferrer Ex. 630 at 61. Dividends went up and all Funds traded above NAV. Ferrer Ex. 630 at 8.

4. For the quarter ended February 12, 2009, the annual average market return for the 22 Funds was between 5.11% and 7.97%, dividends were generally higher and all Funds traded above their NAV. Ferrer Ex. 631 at 8.

5. For the quarter ended May 27, 2009, 5 of 22 Funds had negative 1-year market returns with reinvestment, but all Funds had positive annual average returns that ranged from 5.36% to 7.56%. Ferrer Ex. 632 at 59. Dividends were generally stable. Div. Ex. 632 at 8. Three Funds had dividend increases and all Funds traded above NAV. Id.

6. For the quarter ended August 27, 2009, 14 of the 22 Funds had negative market return with reinvestment as of June 30, 2009, but all Funds had positive annual average returns that went from 2.33% to 7.49%. Ferrer Ex. 633 at 48. Dividends were stable to higher, all but 2 Funds were trading above their NAV, and there were share repurchases during the quarter. Ferrer Ex. 633 at 16.

For each quarter in 2008, and the first quarter of 2009, similar information was available to FAs in a single sheet that showed Market Performance with Reinvestment for year to date, 1 year, 3 years, 5 years, and 10 years for each Fund. Tr. 1324-25; Ferrer Exs. 645-50. In addition, each Fund had a Quarterly Review that was given to clients. Tr. 1305-26; Ferrer Exs. 634-39.

During 2008-2009, Ferrer received information measuring the risk/return over a 10-year period of 7 Funds that had existed for 10 years against other indices and a separate analysis measuring the Funds risk/return against about 150 municipal funds. Tr. 1318-20; Ferrer Ex. 640. The risk/return graph for the 10 years respectively ended March 31, 2008, June 30, 2008, September 30, 2008, December 31, 2008, and March 31, 2009, showed that most of the 7 Funds had a higher return and lower risk than almost all the other indices and over about 140 municipal funds. Tr. 1320-23; Ferrer Exs. 640-44.

<u>Information to clients and prospective clients</u>

Each Fund's prospectus had a section, Risk Factors and Special Considerations, that stated that UBS PR is not obligated to maintain a market in Fund shares and FAs are supposed to always disclose this fact to investors. Tr. 188, 192-93, 261-62; Div. Exs. 22 at Bates 1254, 47, 123; Ferrer Exs. 500-22, 541; Ortiz Ex. 214. Each Fund prospectus contains language similar to the following contained in the Puerto Rico Fixed Income Fund prospectus:

> [UBS Puerto Rico] currently intends to maintain a market in the shares, although it is not obligated to do so, and may discontinue such activities at any time. No assurance can be given as to the liquidity of the market for the Shares as a result of such activities by UBS Puerto Rico. If UBS Puerto Rico's activities are discontinued at any time, there may be no other market for the Shares.

Div. Ex. 22 at Bates 1254; Ortiz Ex. 201 at 12, n.7.

The Family of Funds' brochure dated February 4, 2008, described the difference between closed and open-end funds. It stated:

1. After the IPO, Fund shares are traded through the UBS PR Trading Desk; shares do not trade on any exchange;

2. Market factors such as supply and demand and the yield of similar products determine the share price;

3. UBS PR is not required to purchase Fund shares;

4. The market price of Fund shares may trade at premium or discount to NAV. The price is determined by how much buyers are willing to pay and sellers are willing to accept and how the Funds are performing compared to similar instruments and not primarily by the NAV of the Fund holdings;

5. UBS PR currently intends to maintain a market in Fund shares and has since 1995, but it is under no obligation to do so, therefore there may be occasions when customers may be unable to sell shares or will be able to sell at a loss or a significant loss;

6. Fund prices are not publicly reported but UBS PR provides share prices for weekly publication in local newspapers; and

7. FAs may earn compensation on transaction, which will reduce the net proceeds to customers on sales or increase the cost of purchase.

Tr. 542, 1338-41; Div. Ex. 123 at 3; Ortiz Ex. 214; Ferrer Ex. 543. Information that UBS PR is not obligated to maintain a market in the Fund shares so that customers may be unable to sell is stated twice. Ferrer Ex. 543 at 3, 7.

On June 19, 2007, Legal & Compliance ran a meeting for FAs. Frank Pluchino (Pluchino), Deputy Chief Compliance Officer in 2008-2009, followed up with an e-mail reminding FAs of their obligations, which included a list of risks when discussing the Funds. Tr. 2448-49. The risks included: Fund share prices were based on supply and demand and other factors; Fund share prices may be less than the NAV; UBS PR currently intends to maintain a market in Fund shares, but it is under no obligation to do so and there may be occasions when customers will be unable to sell shares or will be able to sell at a significant loss. Tr. 1331-35; Ferrer Ex. 541. Ferrer was sure that FAs communicated this information to customers, and that the disclosures in the prospectus, brochure, and FA compliance training were contained in every document that UBS PR prepared. Tr. 1335, 1340.

Secondary market

UBS PR does not publish bids and offers for Fund shares to the general public. Tr. 295. That information was available from FAs through the inventory sheets or Bonds on Line, which could be used to enter orders. Tr. 296, 1639; Div. Ex. 98; Ortiz Ex. 370. Fund shares were not traded or sold on any exchange and the prices were not publicly quoted in any service. Tr. 31. In the secondary market, UBS PR considered that it provided a facilitating function by: (1) matching buys and sells or, stated differently, purchasing securities to facilitate a riskless principal trade, i.e., marrying a seller and a buyer;[22] or (2) where that was not possible, providing liquidity by purchasing shares into inventory for resale. Tr. 68-69, 153, 305, 574, 1008-09. UBS PR acts as the sole liquidity provider for Fund shares. Div. Exs 10-11; Ferrer Exs. 500-22; Ortiz Ex. 218. Liquidity is the degree to which an investment can easily be sold or converted into cash. Div. Ex. 21 at Bates 0071.

The Trading Desk actively tried to match large orders, but in general, UBS PR traded as a principal, buying and selling from customers. Tr. 527. The firm did not engage in proprietary trading of the Funds; rather, inventory was held to provide liquidity so as to facilitate customer trades and to provide product for the FAs. Tr. 1011-12, 2838. Ferrer testified that when the Funds began, there was little secondary market trading and it took a long time for people to buy and sell. The present system evolved from early efforts to assist clients. Tr. 1013, 2011-13. Ferrer believes that the firm has a responsibility to its customers to provide liquidity. Tr. 1016-

[22] A riskless principal transaction occurred where the Trading Desk located both a buyer and a seller before the trade was executed. Tr. 69.

17. At some point in the 2008-2009 period, Ferrer became aware from FAs that UBS PR was not buying shares, but this had occurred many times previously. Tr. 1208-10. Ferrer estimated the market in Fund shares at $5 billion, and about two-thirds of the Fund shares were held in UBS PR customer accounts, about one-third were held by customers with accounts at other firms, and some holders had multiple accounts at several firms. Tr. 1096-98. The trading desks at other firms gave quotes on Fund shares and shares of their own funds. Tr. 1094-99.

On July 1, 2009, Ortiz circulated UBS PR Secondary Market Order Handling and Trading Guidelines for the Funds (Handling and Trading Guidelines), which stated that if the Trading Desk stopped providing firm bids or offers the following would happen:

> a. The Trading Desk informs FAs that the Firm is no longer providing firm bids or offers by changing the bid/offer quantity to "1" on Bonds on Line (BOL). (footnote omitted)
>
> b. FAs are responsible for informing customers who want to buy or sell Fund shares that the Firm is not currently bidding or offering the shares. FAs are instructed to make clear to customers that a market imbalance exists which may increase the time to sell, as the Trading Desk tries to locate a buyer and that the price may differ from current price indications.

Div. Ex. 94 at Bates 0219.

In 2009, secondary trading in Fund shares was over $1 billion and the market capitalization was in the $5 billion range. Div. Ex. 125.

<u>Pricing Fund shares</u>

An open-end fund constantly offers and redeems fund shares at NAV. Tr. 29. Closed-end funds are quite different. In this closed-end fund situation, persons at the Trading Desk, primarily Carlos Rosado (Rosado), the head trader, and Ramon Prats (Prats), another Fund trader, engaged in thorough discussions with Ortiz about prices, furnished Ortiz with information from FAs, and recommended bids and offers for Fund shares.[23] Tr. 25, 46, 273, 275, 277, 544, 560, 581-82, 856-57. For example, on October 14, 2008, Rosado recommended that they raise the share prices for the Funds that invest primarily in AAA-rated securities and lower the share prices for the Funds that invest in all investment-grade securities.[24] Tr. 395-97; Div. Ex. 65. UBS PR had written policies that covered firm bids and offers. Tr. 289-90; Div. Ex. 94 at Bates 0218-19. Deciding to use an indicative, rather than a firm bid, was part of the pricing process.

---

[23] Rosado worked previously in operations with Dean Witter Reynolds and Drexel Burnham Lambert. He has been a Fund trader since 1997. Tr. 845-46.

[24] On October 14, 2008, the market for Fund shares was not in balance. The inventory was at $44.3 million and there were $6.8 million GTC orders. Rosado anticipated receiving many orders to sell shares received as dividends and if re-pricing did not occur, he would need to seek to increase the inventory limit from $45 million to $50 million. Tr. 395-97, 919-20; Div. Ex. 65.

Tr. 881, 883. According to Rosado, if there was high inventory and open orders, using an indicative bid would let the Trading Desk find out the correct price for Fund shares. Tr. 277-78, 883-84, 980.

According to Ortiz, setting Fund prices is a process of analyzing and weighing information, and not the application of a formula. Tr. 286-87. Ortiz testified:

> This is a small market made up of people speaking to people. . . .
>
> It's not an automated market. It's not a screen market. It's a people market. And so there's a lot of information that you obtain from that. . . .
>
> Indicators – I mentioned supply and demand, order flow, inventory, yields, dividends, information – oh, obviously, market conditions, you know, what's going on with the market conditions in Puerto Rico. Are there any news about the Puerto Rico credit, which underlies many of these closed-end funds? Are there any news about future deals? That's a great indicator of where supply and demand may go.
>
> And when I say "future deals," I mean municipal offerings in Puerto Rico, which attract attention of the market for quite a bit of time.
>
> We take a look at interest rates, where are interest rates going, especially short-term interest rates, which have a significant impact on the leverage ability of funds and the cost of funding of the funds and, therefore, the dividend payments that they put out. General market conditions.
>
> So it's many factors that we take a look at, and we discuss on a constant basis, in that effort to look for a balance between supply and demand.

Tr. 282-83.

Ortiz considered market information in making pricing decisions with the goal of finding a balance between supply and demand and thus maintaining an orderly market. Tr. 279, 281, 414, 418, 678, 685. The testimony is unanimous that yield was the key driver in the Funds' supply and demand. Tr. 462-63, 851, 996, 998, 1005, 1007, 1360. In pricing Fund shares, the Trading Desk compared a Fund's yield to yields on 20-year local municipal bonds because in a fixed-income market yield is very important and investors evaluate Fund yields with returns on other investments. Tr. 152. The primary pricing information was order flow, meaning the incoming buys and sells, yield on other fixed income instruments such as local municipal offerings, the transactions the Trading Desk could do with other broker-dealers in Puerto Rico, and the GTC book. Tr. 281, 850. Rosado considered GTC orders in setting prices. Tr. 852. Principally, the Funds compete with municipal securities and investors compared the after-tax yield of the Funds, municipal securities, and mortgage-backed securities. Tr. 536-37. Other factors involved in Fund pricing decisions were the size and the age of the inventory, feedback from FAs, and general market conditions. Tr. 282-83. Ortiz testified that in his experience changing Fund prices up or down had little impact on demand, but the evidence is that the Trading Desk lowered prices and increased sales, thus lowering the value of the Funds' inventory. Tr. 534, 925, 972-74.

Ubinas considered the two most important factors in Fund pricing were supply and demand and the yield of competing securities. Tr. 2856-57. Ubinas opined to Price on May 22, 2009:[25]

> [l]ocal investors hold the funds and view the funds as a proxy for other fixed income alternatives, namely PR municipal bonds. As a result and as [Ortiz] has noted in the past the funds trade more on the basis of the dividend level than they do on the basis of NAV, although in the end supply and demand is the critical factor. That is not to say that NAV is not important, but rather that dividends are most important. Moreover, as you have correctly always noted, the NAV does not capture the tax benefits value inherent in the funds structure.

Tr. 461-62; Div. Ex. 125.

On September 2, 2008, Ferrer e-mailed Ubinas; Ortiz; Leslie Highley (Highley), Head of Asset Management; Belaval; and others stating that he had "asked Roberto: to (1) open up our AAA Fund. (2) File for Fixed Income VI. I want these to happen, right away. I do not want to keep postponing new availability for reasons of inventory, no way!"[26] Tr. 1050; Div. Ex. 32. The AAA Fund was an existing Fund and reopening it up meant issuing additional shares. Tr. 1050. Fixed Income VI was a new Fund. Tr. 1050. Ferrer disagreed with Belaval, who thought there were sufficient Fund shares in the market. Tr. 1429. Ferrer believed that the public should have a wide selection of different investments, and at this particular time, a new Fixed Income VI Fund would: (1) not be sold at a premium over $10 or par; (2) have available many new bonds for its portfolio; and (3) could use existing low interest rates to take advantage of leverage. Tr. 1053-54, 1429-30. On September 10, 2008, Ferrer e-mailed all FAs that this action would have little direct effect on the secondary market addressing the concerns of some that there were already sufficient Fund shares in the market. Tr. 1061; Ferrer Ex. 556.

Market conditions changed at the end of 2008 and in early 2009, because of events including the bankruptcy of Lehman Brothers, the crisis at AIG, the federal government's Troubled Asset Relief Program, and local Puerto Rico happenings. Tr. 585. For the first time in Ortiz's experience, yields on Puerto Rico bonds sold in the United States municipal tax-exempt market had higher yields than tax-exempt bonds sold in Puerto Rico.[27] Tr. 587. Some Fund

[25] Price was on UBS's Executive Committee, Operating Committee, and Risk Committee. Tr. 2495.

[26] Roberto Fortuno was a banker in charge of drafting Fund filings. Tr. 1427-28.

[27] The preferred venue for Puerto Rican issuers of municipal securities is the tax-exempt market in the continental United States, which is available if the securities qualify for federal tax-exempt status. Towards the end of 2008, the capital needs of the Puerto Rican government increased, and

shareholders sold their shares and invested in the Unites States markets. Tr. 588. In addition, a new government administration in Puerto Rico found a $3 billion budget deficit. Tr. 589. These local events had a tremendous impact on investor behavior. Tr. 589-90. Ortiz testified in 2012, that the market in 2008-2009, especially in February and March 2009, as the most difficult time in his almost twenty-eight year business career. Tr. 353, 435-36. In 2012, Ferrer shared this position. Tr. 1336-37.

On December 11, 2008, Eladio Perez-Llama (Perez-Llama), an FA in the Mayaguez branch, e-mailed Rosado, "What the hell is happening with the funds??????" Tr. 2199-2200; Div. Ex. 148. Rosado explained that he had to lower the prices: "This is a supply/demand issue. I had to adjust because of the salesmen that are below the bid, or could not process the reinvestment." Tr. 586, 2202; Div. Ex. 148. Perez-Llama responded:

> To add more rubbish to our list of excuses (POB, PREFERRED, PR BANKS, DJIA, SP500 etc. etc. etc.) Merry Christmas[.]

Tr. 2199-02; Div. Ex. 148. Rosado e-mailed back:

> They are not EXCUSES, I do not control the market, all to the contrary, I only reflect market movements.
>
> MERRY CHRISTMAS

Tr. 2199-02; Div. Ex. 148.

The Trading Desk sent FAs daily a Funds Intraday Inventory spreadsheet (inventory sheet) for internal use only that showed basic information about each Fund, including the bid and ask prices and number of shares. Tr. 376. Between April 1, 2008 and September 30, 2009, the inventory sheets consisted of a series of columns showing, among other things, the Fund name, CUISP, last dividend, NAV, bid and offer, number of shares it would buy or sell, and reinvestment discount. Tr. 865-68; Ortiz Ex. 370. The inventory sheets were very important to the FAs because they indicated the Trading Desk's capacity to buy shares, and they showed the yield at each commission level. Tr. 1287; Div. Ex. 4.

The GTC book, also called the intraday sheet, was sent to the same people that received the inventory sheets after February 2009. Tr. 871, 958, 961-62. Before that date, it was kept at the Trading Desk but not distributed to FAs. Ferrer did not regularly receive copies of the GTC book in 2008-2009, but occasionally saw copies. Tr. 1085. The GTC for May 7 and May 8, 2009, showed, among other things, the dollar value of total available inventory, marketable orders, non-marketable orders, and the percentage of the each Fund's inventory limit that was

---

federal tax exemption rules became stricter. Tr. 586. These facts caused the local Puerto Rican municipal market to increase in size. Tr. 586-87.

being used.[28] Tr. 872-77; Div. Exs. 58-59. The Trading Desk stopped showing the actual number of shares in inventory at the end of August 2008, because Ortiz believed the sales force was using inventory levels to pressure traders for changes in Fund prices. Tr. 338-89, 661. FAs complained that they needed to know whether shares were available to sell so the inventory sheets eventually showed inventory using a scale with a maximum figure of 100,000, 200,000 or 300,000. Tr. 388-89, 391-92, 661-62, 670-71. Ortiz denies that the changes to the inventory sheets were an attempt to conceal the status of inventory, that the inventory situation was a problem when the inventory sheets were changed, and that inventory was a problem in 2008 and 2009. Tr. 662-63. Ortiz testified that at its highest point, the value of inventory was less than 1% of the value of the Funds total shares. Tr. 663. Ortiz disagrees that there was a liquidity crisis in Fund shares in September 2008. Tr. 671, 673.

Rosado testified that he sometimes told FAs, at times of market imbalance, that: (1) he needed to sell inventory: (2) he was lowering prices to reduce inventory; and (3) he could not increase inventory. Tr. 955-57. In times of market imbalance, Rosado advised FAs to place an order to sell, which the Trading Desk would try to execute, but cautioned that it might take some time to execute. Tr. 957, 985. Buys and sells occurred at times when the Trading Desk posted indicative bids. Tr. 982.

Fund shares stayed at fixed levels for long periods. For example, the Division represented these unconfirmed bids for the:

- Tax Free Puerto Rico Target Maturity Fund was $9.50 from May 2 to December 12, 2008;
- Puerto Rico AAA Portfolio Target Maturity Fund was $9.15 from May 2 through August 29, 2008;
- Puerto Rico AAA Bond Fund was $9.10 from May 2 through August 29, 2009;
- Puerto Rico AA Bond Fund II was $9.55 from May 2 to September 9, 2008;
- Puerto Rico Mortgage-Backed U.S. Government Fund was $9.10 from May 2 through August 26, 2008;
- Puerto Rico Ginnie Mae Fund was $9.30 from May 2 through September 26, 2008;
- Puerto Rico Fixed Income Fund I was $9.70 from September 2 through December 11, 2008;
- Puerto Rico Fixed Income Fund II was $9.50 from May 2 through July 7, 2008;

[28] The GTC book does not identify which orders were marketable when placed, but that are no longer marketable because of price changes made by the Trading Desk. Tr. 989.

- Puerto Rico Fixed Income Fund III was $9.70 from September 2 through December 9, 2008;
- Puerto Rico Fixed Income Fund IV was $9.65 from May 19 to July 31, 2008;
- Puerto Rico Fixed Income Fund V was $10.00 from May 5 to July 7, 2008;
- Puerto Rico Investors Tax-Free Fund II was $9.85 from May 2 through August 29, 2008;
- Puerto Rico Investors Tax-Free Fund III was $9.95 from May 2 through October 17, 2008;
- Puerto Rico Investors Tax-Free Fund IV was $10.00 from May 19 through September 30, 2008;
- Puerto Rico Investors Tax-Free Fund V was $10.00 from May 19 through September 30, 2008; and
- Puerto Rico Investor Bond Fund was $9.70 from July 8 through December 9, 2008.

Tr. 418-22.

From May 1, 2008 through March 19, 2009, the Funds' aggregate buy volume was $540.6 million, and the aggregate inventory increased by $18.5 million. Tr. 637; Ortiz Ex. 382. Ortiz takes these figures to mean that although there were open orders, the Trading Desk did a fantastic job of supplying Fund shares, and he denies that the Trading Desk bought shares for inventory to prop up the share price as the Division alleges. Tr. 639.

Indicative bids

Ortiz decided whether to post firm or indicative bids. Tr. 881-82. UBS PR did not inform the general public that it posted indicative, rather than firm bids. Tr. 62. From May 2008 until September 2009, the Trading Desk published more indicative bids than firm bids. Tr. 352-53. The evidence is that FAs knew from the continuous posting of indicative bids for a Fund that there was an oversupply of shares. Tr. 981.

UBS PR sent *El Vocero*, formerly the San Juan Star, a list of Fund offer prices and NAVs and each Monday the newspaper printed each Fund's NAV, precio (price), and yield. Tr. 47, 51, 323-24; Div. Exs. 1, 54. According to Ortiz, the price shown was the maximum amount at which the Trading Desk had been willing to sell shares during the preceding week. Tr. 324-28. The published information did not state that the price included a 3% markup for the FA. Tr. 54, 328. UBS PR intended this information would indicate to the public where the securities had been valued the prior week. Tr. 51-54. The price information published in *El Vocero* was not identified as indicative prices. Tr. 49-51, 54. UBS PR did not provide the public with information as to actual trade prices. Tr. 329. The Fund prices that appeared in *El Vocero* were not the same as the offer, plus the 3% markup, that appeared on the inventory sheets the Trading desk supplied to the FAs. Tr. 331-40. Ortiz testified that they could not correspond. Tr. 333, 340.

Doreen Castaner (Castaner) has worked for UBS PR for 13 years. In 2008-2009, Castaner was Marketing Manager and arranged for advertising as part of her responsibilities. Tr. 2253-54. UBS PR gave copies to an advertising agency, Lopito, Ileane & Howie. The proofs were reviewed by the requesting department, legal and compliance, and then the advertising agency provided it to the newspaper, *El Vocero*. Castener testified that in 2008-2009, UBS PR did not pay for the information the newspaper published as to Fund prices. Tr. 2257-59.

The number 10 in the bid column and 100,000 in the number of shares column on the inventory sheets indicated that the Trading Desk was willing to buy 100,000 shares at $10 a share on a firm basis. Tr. 59-62, 298; Div. Ex. 98. A 1 in the number of shares column indicated that the prices shown were indicative and the Trading Desk was unwilling to buy any significant amount of shares at the prices shown. Tr. 61, 301-02, 718, 879. An indicative bid indicated a lack of demand, the Trading Desk was not obligating itself to buy any amount of shares at the quoted price, and execution of sell orders may take time. Tr. 291-99, 543, 879, 980. Ferrer testified that when FAs saw an indicative bid, they realized the Trading Desk was reaching the maximum inventory and was not obligated to buy shares. Tr. 1396. One experienced FA saw it as a starting point in negotiations with the Trading Desk. Tr. 2249-50. The Division's expert calculated that UBS PR posted indicative bids approximately 8% of the time between September 2007 and May 2008, 59% of the time between May 2008 and March 2009, and 96% of the time between March 2009 and September 2009. Div. Ex. 153 at 10.

Some trades occurred at the indicative bid level and riskless principal trades continued when indicative bids were posted. Tr. 317-18, 880. The UBS Pricing Department (Pricing Department) reflected the changes in client accounts available to online clients the following morning. Tr. 561-64. The Trading Desk provided end-of-month prices to the Pricing Department, which used indicative or firm bid information in customer monthly statements. Tr. 884-85.

The markets for many of the Funds were illiquid in 2008-2009. Tr. 2023. A decision to change from a firm bid to an indicative bid could happen abruptly. For example, on May 15, 2008, the Trading Desk had firm bids for all Funds. Tr. 880; Ortiz Ex. 370. At 12:05 p.m. on May 15, 2008, Rosado e-mailed to a broad list of people in Puerto Rico that "fund bid share amount is [equal] to one share," changing the bids from firm to indicative. Tr. 984; Ferrer Ex. 546. On May 15, 2008, UBS PR could not purchase the $10.2 million in executable GTC orders for inventory because adding that amount to its existing $36.8 million inventory would have caused UBS PR to exceed its inventory limit. Tr. 898-99.

Market liquidity and price stability were the two objectives of the Funds' market making activities, according to Ortiz. Tr. 477-79; Div. Ex. 22 at Bates 1254. Price stability is the degree to which the market price of an investment remains constant over time. Div. Ex. 21 at Bates 0071. Ortiz's May 2009 presentation about the Funds' secondary market for UBS management stated that the Trading Desk: (1) always showed a firm or indicative bid and offer and (2) published all open marketable orders daily to provide transparency and to allow buyers and sellers to take advantage of market conditions. Div. Ex. 22 at Bates 1255.

On May 16, 2008, Ortiz advised Ubinas and Belaval that the market continued to be out of balance and the Trading Desk had $37 million in inventory and a lot of GTC orders at executable levels, which it was going to have to execute, or change the UBS PR price so they were not executable.[29] Tr. 354-59; Div. Ex. 2. To create space for purchases, Ortiz opted to lower the prices for shares of several Funds. Tr. 359; Div. Ex. 2. On May 16, 2008, UBS PR posted indicative bids for all the Funds. Tr. 356-57, 880; Ortiz Ex. 370.

On June 12, 2008, Ortiz e-mailed Rosado regarding the Funds' inventory, "Carlos, we need to develop a sales story around the Tax Free PR Funds I and the PR Fixed Income Funds I and II," that should include the information that there will not be a new PR Fixed Income Fund VI for at least a couple of months, the Trading Desk can do special transactions at reduced spread, and should compare assets, yields, dividends, etc. "The idea is to bring down these Funds to close to $2m each." Tr. 365-69; Div. Ex. 61. Ortiz expected Rosado would give this information to the FAs as an attempt to raise demand and reduce inventory. Tr. 367-68. Rosado interpreted Ortiz's e-mail as meaning that he should prepare material for the FAs highlighting the yields these particular Funds offered as compared to the yields on other Funds. Tr. 902.

Market conditions for the Funds changed in the period December 2008 through February 2009. Tr. 683-84. Conditions thought to be temporary turned more serious and permanent. Tr. 683-84. On January 16, 2009, Rosado suggested to Ortiz, that to resolve the Funds' market imbalance, that they tell FAs to place offers to buy at any price. Tr. 926-27; Div. Ex. 16. In the summer of 2009, the price of some Funds dropped; however, Ortiz testified that the main cause of customer anxiety was the length of time it took to execute trades because UBS PR was not actively buying shares. Tr. 481. Ortiz believed liquidity was the Fund customers' one concern. Tr. 481.

Dividend reinvestment

Fund owners of record, on the last day of each month, are paid dividends around the 15th of the month. Tr. 547-48, 885. Shareholders can opt to receive cash or, alternatively, to reinvest the dividends into shares priced at NAV. Tr. 78. About half of the shareholders elected to reinvest their dividends in Fund shares, and half of this number quickly resold them because most of Funds traded at a premium to NAV. Tr. 79-80, 869. Orders to sell shares received as dividends were limit orders. Tr. 700.

The Trading Desk received 1,000 or 2,000 additional transactions each month as a result of dividend reinvestments. Tr. 348, 700, 886; Div. Ex. 14. Many shareholders counted on the money from the sale of their reinvested shares for living expenses and they expected same day execution of their sale orders. Tr. 84, 113-14. Customers and FAs got upset when they could not sell shares quickly. Tr. 113-14, 117, 1047. In 2008-2009, about 25% of each Fund's

[29] On May 30, 2008, UBS PR had open GTC sell orders of $7,607,681.55. Tr. 363.

shareholders sold their dividend reinvestment shares, which amounted to between $3 million and $7 million in trades each month.[30] Tr. 80-83, 114, 342; Div. Ex. 15. The sale of these additional shares put added pressure on the Fund market which was already out of balance. Tr. 113, 116, 341, 350-52. UBS PR determined they could not eliminate the program because it was part of the original IPO, and other measures were nixed by the Legal and Compliance departments. Tr. 113-15.

In October, November, and December 2008, BOMs and FAs complained about the time it took to sell dividend reinvestments. Tr. 345-49; Div. Exs. 12, 14, 17. FAs were upset mainly because they were not able to execute transactions to provide clients with income. Tr. 1632. This was especially true of small retail FAs. Tr. 1630-31, 1641. UBS PR advised its FAs that it could not guarantee a time frame for selling shares and that customers should opt for receiving cash dividends if they needed to receive money right away, and it tried to increase demand by giving FAs training and information about the Funds. Tr. 85, 115. One FA testified that in the 2008-2009 period, his BOM told him the reinvestment program was being curtailed. Tr. 1640-41.

On December 19, 2008, Ferrer e-mailed Ubinas, Belaval, and Ortiz that there were numerous complaints from FAs about lack of liquidity and stated, "This is not good." Tr. 117; Div. Ex. 83. Ortiz responded that:

> given conditions in the 103 market and the GDB deal, there is limited investors' focus in other products in the secondary market. We are trying very hard to provide the best liquidity possible at this time (in a fully transparent and fair way to investors).[31]

Tr. 695; Ortiz Ex. 277. Belaval informed Ferrer that requests had been made to increase inventory levels, but Ferrer was not involved in the decision to seek the increase. Tr. 119-20. Belaval did not recall discussing the dividend reinvestment program with Ferrer because it was "problematic for the trading desk, but in the scheme of things, it was still a small amount in relation to the overall secondary trading for the month." Tr. 120. Ortiz testified that there was a lot of trading activity during this period and he believed that prices were at appropriate levels, but the GDB deal in particular was making the situation challenging. Tr. 696. A former FA testified that FAs were pretty upset in late 2008 about the time it took to execute orders, especially orders to sell shares from reinvested dividends. Tr. 1576

On April 7, 2009, based on information from FAs, Ferrer inquired of Belaval, Ortiz, and others whether the dividend reinvestment program had increased to such a size that the "extra

[30] The sale of reinvestment shares is impossible to track so these percentages and numbers are estimates. Tr. 343, 346.

[31] The reference to 103 paper is to Puerto Rico bonds which were issued in the United States tax-exempt market until conditions changed and they began issuing them in Puerto Rico, which increased the size of the Puerto Rico capital markets. Tr. 585-87, 1283, 1297-98.

supply affects the markets for funds." Tr. 1201; Div. Ex. 36. Belaval and Ubinas told Ferrer that the sale of reinvested shares was not "crowding out" transactions by other customers. Tr. 1203. Rosado, however, acknowledged that this could have happened in some Funds, and on April 16, 2009, Ortiz expressed to Michel a concern that the sale of reinvested shares was locking up the market. Tr. 888-89. Rosado testified that Ortiz's statement about locking up the market was very strong, and he had never experienced a lock up in the market from reinvestment share sales. In his opinion, it could happen in one Fund, while other Funds were trading normally. Tr. 891. Michel reported to Toni Stadelmann, UBS CFO, who was replaced by Tom Naratil (Naratil) around May 19, 2009. Tr. 2514, 2638.

Ubinas informed Michel that Ortiz had been forced to tell an FA that the Trading Desk was not a buyer of Fund shares. Div. Ex. 39. Ubinas was concerned that this information could cause a snowball of sell orders. Id. Michel's response acknowledged that the Trading Desk was under pressure, however, an increase in inventory limits would increase risk relative to UBS's expected earnings. Id.

Inventory limits

UBS PR maintained an inventory of Fund shares so that the Trading Desk could facilitate the market by providing liquidity and to provide product to the sales force. Tr. 573-74, 594. The Risk Committee set a limit in terms of dollars for the Funds' overall inventory and for the inventory of individual Funds. Tr. 70, 72, 357-58. When Ortiz joined UBS PR, he began trying to get a much higher inventory limit for the Funds, typically 1% of market capitalization, with the ability to request additional increases so that it would have additional liquidity in certain market conditions. Tr. 437, 501-02, 752-53. In 2003, Ortiz was able to get the Funds' permanent inventory limit increased to $30 million, which was close to 1% of the Funds' market capitalization, and it remained there, with the possibility of temporary increases, through at least May 2008, while the number of Funds had increased. Tr. 70, 140-41, 172, 357, 501, 624, 757, 897, 1020; Div. Ex. 46.

If Ortiz thought that a market imbalance was temporary, he would get management's support and request an increase in inventory from UBS so that the Trading Desk could buy more shares and increase market liquidity.[32] Tr. 98, 358-59. Michel would act on the requests, sometimes consulting with Price. Tr. 2523. Ferrer was not involved in making decisions on the Funds' inventory limits, but he was copied on e-mails requesting inventory increases and was knowledgeable on market conditions. Tr. 214-15, 243-46. In his investigative testimony, Price stated that UBS PR's sporadic requests to raise inventory increased in 2008, and it took longer to come back to the prior level because of liquidity and "bank stocks tanking in 2007." Tr. 2516-17.

On April 28, 2008, Ortiz e-mailed a request for a temporary increase through May 2008, in the Funds' overall inventory limit from $30 million to $40 million. Tr. 358-59; Div. Ex. 67.

[32] Some of the requests were sent to UBS by Rosado after getting approval from Ortiz who obtained approval from Ubinas and Belaval. Tr. 373.

Specific limits on the Puerto Rico Fixed Income Fund I would increase from $5 million to $7 million and the Tax Free Puerto Rico Fund II would increase from $5 million to $6 million. Div. Ex. 67. UBS approved the request. Tr. 359.

On May 16, 2008, Ortiz e-mailed Ubinas and Belaval that:[33]

> The market of funds continues to be out of balance. We have $37m in inventory and a lot of GTC orders that are at executable levels, therefore, they have to be executable or change the price of the fund so they are not executable any more. We are opting to lower the price of several funds, in order to create space for purchases for the reinvestment of dividends that starts today.
>
> Given the 'supply' of paper expected (Housing, Tourism, POBs, COFINA[34]) we don't see another solution at this moment.

Div. Ex. 2.

In 2008, UBS PR opened the Puerto Rico Fixed Income Fund V and Puerto Rico Fixed Income Fund VI, and issued additional shares in the AAA Portfolio Fund II. Ortiz testified that offerings in 2008 did not cause liquidity or market balance problems. Tr. 380-83, 650.

Rosado, with Ortiz's approval, made separate requests to increase temporarily the Funds' overall inventory position limit from $30 million to $45 million in June, July, and September 2008; and on December 3, 2008, he requested an increase to $50 million until January 31, 2009.[35] Tr. 372-78, 383, 407-08, 674, 911-14, 926; Div. Ex. 127; Ortiz Exs. 249, 254, 279, 372. Ortiz's standard operating procedure was to get the support of Ubinas or Belaval, for the requests and to make them in anticipation of the inventory increase. Tr. 378, 383-84, 408, 654, 2839-40. Ubinas testified that he is pretty sure he approved each request and he considered the fundamentals that they laid out to be right on point. Tr. 2840. In most of the requests, Rosado stated that he expected a return to normal secondary market conditions. Tr. 107; Div. Ex. 127. The July 30, 2008, request stated that Fund yields were up to 6.6% after taxes and for customers that reinvested dividends, it would be a 7.9% yield. Tr. 655; Ortiz Ex. 249. Ferrer was copied on some of the e-mails. Tr. 244-45, 1023-28, 1036-37, 1056, 1115; Div. Exs. 67, 127. When it requested an inventory increase, UBS PR expected to be able to sell the securities at that price or more in the future. Tr. 195.

---

[33] Ferrer was not copied on the e-mail. Tr. 216. On May 30, 2008, the aggregate inventory for the Funds was $37,902,408.01. Tr. 362.

[34] COFINA are transactions by Puerto Rico. Tr. 2900.

[35] The requests followed the same format. They stated where inventory stood and what was expected. Most of the requests also specified increases in the inventory levels of specific Funds. On August 29, 2009, the request was only for inventory increases in the Tax Free Puerto Rico Fund I and the Puerto Rico Investors Tax Free Fund III. Tr. 656-57; Ortiz Ex. 254.

On September 8, 2008, Michel approved an increase from $30 to $45 million until September 30, 2008. Tr. 672; Ortiz Ex. 255. On October 15, 2008, Rosado informed UBS's Risk Officer that he was over the $45 million inventory limit and, with dividend reinvestment sales, he would likely be $48 to $50 million at the end of the day. Div. Ex. 65. Rosado stated that he would execute sell orders for reinvestment shares below 1,000 shares and discuss with management strategies to stabilize the market, which meant re-pricing Fund shares to find equilibrium. Tr. 921-23; Div. Ex. 65. By October 20, 2008, 15 of the Funds had changed prices in order to stabilize the market. Tr. 974.

On December 16, 2008, Rosado informed Ortiz that current inventory was at $50.1 million and that he would revise prices the next day to bring the inventory down to $50 million. Tr. 409; Div. Ex. 66. Ortiz testified that the Funds did not face a liquidity crisis or an inability to facilitate trades from May through the fall of 2008.[36] Tr. 616-17.

UBS PR had group management meetings, co-chaired by Ferrer and Ubinas that met monthly or quarterly. Tr. 108-09, 1044. Either this group or another group was referred to as the secondary market enhancement group. Tr. 388, 661. Ortiz denies that the "secondary market enhancement group" was formed primarily to increase Fund sales. Tr. 664-66. Twelve people were present at a management meeting on August 12, 2008, at which Highley set out the strategic objective of reaching $15 billion in assets and $79 million in revenue between Asset Management and Fund Administration in 2012. Tr. 109, 1038-39; Div. Ex. 68 at 1. At the meeting, Highley mentioned a weak secondary market for the Funds, and noted that to reach these goals, 5 new closed-end funds would have to be launched between 2008 and 2012. Tr. 1039; Div. Ex. 68 at 2. Following the meeting, Ferrer suggested that a meeting be held with customers by February 2009 to discuss the benefits of owning Fund shares. Tr. 1039-40.

In early 2009, the UBS CFO, prompted by Michel, raised concerns about the size of the Funds' inventory. Tr. 2517. This followed losses of about $50 billion in UBS, AG's global operations where the government of Switzerland had to inject cash into the firm. The result was communications at the highest level of UBS about reining in its risk exposure in inventories in general. Tr. 2517, 2602-03. Michel was concerned about the Funds' inventory buildup in the fourth quarter of 2008 and the spread between NAV and the Funds' bid prices. Tr. 2525. Michel believed that aggressively lowering the bid prices for the Funds would result in greater demand for Fund shares because it would increase yield.[37] Tr. 2521, 2531, 2541. Price did not necessarily agree with Michel because of the uniqueness of the Puerto Rico market and, at the time, people were liquidating assets. Tr. 2541-42.

---

[36] Time period is not clear.

[37] Another idea Michel had was to create a more liquid exchange for Fund shares in Puerto Rico. Tr. 2521.

On January 14, 2009, Rosado informed the FAs to make sure they placed their dividend reinvestment orders with new price levels. Tr. 1145. When one FA replied on January 15, 2009, that this was unacceptable, another FA responded:

> THAT IS CORRECT. The abuse that is doing the desk manipulating prices is unacceptable. In clients' account statements they lowered the price on the last day, for example PR Investor I from 9.60 to 8.70, and the dividend did not change. Yesterday a lady client ordered me to sell all her account because of this reason, and the bid given me was lowered to 8.65, to affect her more. Be prepared, because along will come a complaint from clients.

Div. Ex. 13; <u>see also</u> Tr. 1148. Ferrer requested that Belaval look into the situation. Tr. 1148. Ortiz responded:

> At this moment, there is an imbalance between supply and demand in the Puerto Rico funds market. This imbalance is being created by various factors, including increased supply of governmental paper in the local market . . . higher yields in the Puerto Rico 103 paper (near 8% in some cases) and possible saturation of the funds market. Coupled with these factors is the fact that the dividends on PRITFFs family of funds have increased less than in the Tax-Free Puerto Rico and Puerto Rico Fixed Income families of funds, leading to the former becoming expensive when compared to other investment alternatives. Thus, price adjustments became necessary to begin dealing with the imbalance. We are doing various things to address the situation, including moving full speed ahead with our secondary market enhancement initiatives. We are also contacting all Sales Managers and BOMs to give them a full explanation of market conditions in order to manage FA and clients concerns. And we are working incessantly on making sure we maintain the maximum liquidity in the market under the challenging local and global conditions. I will sit down with [Belaval], as we have done on multiple occasions over the last month, to receive his input and additional ideas on how to manage the situation.

Div. Ex. 97; <u>see also</u> Tr. 1148. Ferrer found Ortiz's explanation for the price changes reasonable and urged better communications so that FAs understood why bids changed dramatically over a short time. Tr. 1149; Div. Ex. 97. He e-mailed Ortiz on January 15, 2009, with copies to BOMs:

> I understand that bids have to follow market conditions, but everyone has to understand why bids change dramatically over a short time span. This has not been done sufficiently, it seems. The [FA] must receive the appropriate justification time and again so they believe. If not, we will pay the consequences the less activity. I suggest another set of meetings in the branches. Please include [Belaval] whenever possible.

Div. Ex. 97; <u>see also</u> Tr. 1149, 1469-70.

One BOM believed that Ferrer was stating that FAs needed information to talk to clients, and there would be meetings at the branches to allow FAs to obtain information and ask questions. Tr. 2126. In addition, on January 15, 2009, Ferrer received a complaint from four FAs that the Trading Desk was not providing good bids when the FAs desired to sell. Tr. 1470-71. Ferrer responded in blunt terms that these were difficult times everywhere including Puerto Rico. Div. Ex. 121.

In February 2009, Ortiz and Rosado gave a presentation on trading Fund shares in the secondary market at one of the branches; FA attendance was mandatory. Div. Ex. 150. According to a former FA, FAs were upset at the lack of liquidity causing management to bring in people to improve the mood. Tr. 1580. The meeting handouts do not mention illiquidity; however, the former FA testified that liquidity was discussed at practically every meeting of FAs during this period. Tr. 1581, 1727; Div. Ex. 150. Ortiz testified that market conditions in February and March 2009 were particularly difficult because Puerto Rico had been in a recession for some time, there were concerns about Puerto Rico's credit rating, a POB offering was receiving negative press, and investors needed money at tax time. Tr. 436. The Funds made three significant price reductions at the beginning of March. Tr. 437. Between March 3 and 4, 2009, the bid prices of 5 of the Funds were unchanged and the bid price for all the other Funds went down. Tr. 826-29; Ortiz Ex. 370.

During March and April 2009, the Trading Desk was trying to achieve a "soft landing" by working back to the $30 million inventory limit without causing market disruptions. Tr. 482, 785. On March 4, 2009, Ortiz directed Rosado to prepare as a first priority Fund prices that matched the lowest executable GTC order. Tr. 443-44; Div. Ex. 73. One FA testified that knowing the Trading Desk was re-pricing Fund shares to eliminate GTC marketable orders would have been significant in recommending shares to customers, because it meant Fund prices were declining substantially. Tr. 1650-51. Ortiz approved the new prices and the amount of executable GTC sell orders went from $16,764,763.85 on March 3, 2009, to $2,885,925.90 on March 4, 2009. Tr. 445-46; Div. Ex. 56 at Bates 0006.

On March 16, 2009, the date within the relevant period of maximum inventory, the value of the Funds' inventory was below 1% of the Funds' capitalization. Tr. 625; Ortiz Ex. 379. On March 19, 2009, Ortiz requested an increase from the temporary inventory limit of $50 million to $55 million for the overall inventory, and specific increases for 3 Puerto Rico Investors Tax Free Funds and 5 Puerto Rico Fixed Income Funds. Tr. 743; Ortiz. Ex. 290. The request cited a supply and demand imbalance in the Funds and that the Trading Desk had significantly adjusted Fund prices. Tr. 744; Ortiz Ex. 290. Ferrer was copied on the request. Tr. 1157-58; Ortiz Ex. 290. Michel denied the Trading Desk's request and told Ortiz he would prefer that the Funds' inventory stay at $50 million. Tr. 753. This was the first time that UBS PR had been denied a request to raise inventory.[38] Tr. 128, 434, 646-47; Div. Ex. 46.

Michel asked Ubinas how "we can manage this down?"; Ubinas replied by increasing demand in the short term, and described events that created the current imbalance as well as a

[38] Ferrer did not receive a copy of the denial to raise the inventory level. Tr. 1160-61.

number of recent positive factors, and reiterated his faith in Ortiz's judgment and ability to manage the situation. Tr. 759; Ortiz Ex. 292. The decision to reduce inventory was made by the UBS CFO and Risk Officer. Tr. 2608. Ortiz was in Weehawken on March 20, 2009, and Price said he directed the inventory reduction because he believed UBS PR was at the peak of its risk appetite. Tr. 434. UBS, AG had liquidity concerns and was making all operating areas "reduce [their] balance sheets" and risk.[39] Tr. 126; Div. Ex. 46. No doubt as a result of UBS, AG's 2008 global losses exceeding $50 billion and the arrival of UBS's new CFO. Tr. 754-55. On either March 19 or 20, 2009, Michel instructed Ortiz to absorb the expected reinvestment of $5 million and to bring the inventory, which was close to $50 million, down to the original limit of $30 million by April 15, 2009. Tr. 129, 431, 756-57; Div. Ex. 46. Michel e-mailed Price, stating in part:

> By the end of March, we will check if the proposed actions to reduce the portfolios are successful. If that's not the case I would suggest to either lower prices or to use the mutual fund purchase program at NAV.

Div. Ex. 46; <u>see also</u> Tr. 2534.

Fund prospectuses allow the repurchase of shares from investors at NAV or below, a drastic measure, which benefits the Funds where the shares are priced above NAV. Tr. 2535. A share repurchase program can only be approved by a vote of the Fund Board according to formal policies which emphasize doing what is best for the Fund. Tr. 1276-77, 2709-10, 2735; Ferrer Ex. 624. The Trading Desk has nothing to do with a Fund's decision to repurchase shares. Tr. 2709-14. Ferrer denied that the Funds purchased shares in 2008-2009 to reduce inventories. Tr. 1278.

According to Ortiz, every day in March 2009 was different. Tr. 761. Belaval's recollection is that in this period, the Funds were doing about $50 million in secondary trading each month. Tr. 129. Between March 18 and March 31, 2009, the Funds' aggregate inventory went from approximately 5.3 million shares valued at $48.6 million to 4.1 million shares valued at $38.7 million. Tr. 760; Ortiz Ex. 209. Ortiz attributed this to the fact that the market was reacting to positive information such as the credit ratings affirmation of Puerto Rico's credit rating, and the Federal Reserve's actions in keeping short-term interest rates low. Tr. 760-61.

On March 30, 2009, Michel made a presentation about the Funds to the Executive Committee of Wealth Management Americas. Tr. 1538-39. In it he stated:

> A supply and demand imbalance has been observed in the Puerto Rico Mutual Fund Market as clients have been exhibiting increasing need for liquidity and have been generally concerned about the credit quality of their investments. The imbalance has started to put pressure on the Puerto Rico Mutual Fund trading

[39] In August 2008, UBS AG reported a second quarter loss of $358 million. It also "reported a net asset outflow of $17 [billion] ($8 [billion] from the USA [sic] alone)." Div. Ex. 68 at Bates 0321.

> portfolio and has increased inventory levels to up to $50mm (end of last week), in excess of current limits.
>
> It was agreed with Puerto Rico trading (Juany Ortiz) to bring inventory levels back in line with the established operational limit of $30mm by April 15, 2009 by selectively lowering prices and by – if necessary – using the Mutual Fund re-purchase program at NAV.
>
> . . .
>
> Puerto Rico Mutual Funds currently trade at a premium to NAV that because the tax exempt status of the fund can be maintained while holding up to 1/3 of securities in U.S. Treasury obligations. In addition, the funds use leverage with low funding rates to further enhance the yields of the funds. Because of the use of taxable rates for up to 1/3 of the portfolio and the use of leverage, the yields of the funds are increased, creating a premium in the market value of the shares. However, in the current environment, the difference between NAV and the price quoted by the trading desk is significant and in some cases above 40%.
>
> Another factor which imposes increased demand for share purchases by the trading desk is the Funds' dividend reinvestment program.
>
> . . .
>
> Risk Control and Compliance to review the current pricing method for the NAV and market value for Puerto Rico Mutual Funds[.]

Tr. 2538-41; Div. Ex. 47.

On March 31, 2009, the UBS Executive Committee contacted Ubinas with concerns that Fund prices were too far above their NAV based on information from Pluchino. The next day, Ubinas and Ortiz explained to Price, Michael Weisberg (Weisberg), head of global products and services, and others at UBS, that NAV was not the factor in pricing the Funds because it does not capture the value investors receive from the tax benefits that are unique to the Puerto Rican market. The widening spreads between Fund NAVs and prices in the first part of 2009, did not overly concern Ortiz or Ubanis because the securities in the Fund portfolios retained their intrinsic value. Tr. 441-42, 778-79, 2920-24. To UBS PR, this seemed to be another situation where changing management required an explanation of the Puerto Rico market. Tr. 779. Pluchino testified that he noted the spread between the Funds' bid prices and their NAVs in February 2009. Tr. 439; Div. Ex. 7. He discussed the subject with his superior and others in Compliance and they concluded that the increase in dividends was the reason why bids were not following the NAV downward. Tr. 2460.

Price and Michel differed in their opinions on certain issues. In March 2009, Michel was concerned that there could be a worst case scenario with more Fund selling which UBS would be unable to support, while Price thought the Puerto Rico economy had come back to stable and the worst was over. Tr. 2616-20; Ortiz Ex. 295. Michel thought Fund premiums were too high and that perhaps the portfolio was not valued appropriately. Tr. 2634. Price tried to educate Michel to the natural premium built into the Funds. Tr. 2634-35. Price believed Fund premiums were appropriate given the circumstances. Tr. 2622, 2633-36. In May or June 2009, Hausmann visited Puerto Rico and reported to Price that he was comfortable with the business and how the Trading Desk was pricing the Funds. Tr. 2630-32.

UBS PR's trading policy in place since 2006, incorporated the "Manning" obligation, i.e., the firm cannot trade for its own account at a price that would satisfy a client order. Tr. 524, 529; Ortiz Ex. 213 at 6. Ortiz testified that UBS PR always has to have the lowest price in order to be able to sell shares from inventory. Tr. 474. In response to UBS's directive, the Trading Desk reduced the prices of some of the Funds to reduce inventory and increase yields. Tr. 432-33, 2569. Because it observed the Manning rule, the result was that some Fund shares were priced below the lowest offer to sell in the GTC Book and those customer offers became un-executable. Tr. 932-35, 975-76. Ortiz did not know that customers were told during this period that UBS PR was buying the minimum amount of shares possible. Tr. 474.

On April 15, 2009, inventory was at approximately $37.6 million; the Trading Desk had not been able to reduce it to $30 million by April 15, 2009, as Michel directed although it had reduced prices in some Funds. Tr. 132-33; Div. Ex. 48. Michel e-mailed Price on April 15, 2009, expressing "my concern [to Ortiz] that by not lowering prices more aggressively we actually allow our clients to manage our positions as we cannot resolve the current supply/demand imbalance." Div. Ex. 48.

On April 15, 2009, Ortiz solicited the support of Belaval and Ubinas for a UBS PR request that the Funds' inventory position be raised from $30 million to $40 million through May 15, 2009, with specific inventory limits in two of the Funds. Div. Ex. 48. On April 16, 2009, Ortiz e-mailed Michel that he would like to talk with him about lifting the expiring inventory limit to $40 million through May 15, 2009. Tr. 447-48; Div. Ex. 39. Ortiz was "concerned that in the middle of the monthly sale of reinvestment shares by clients, we are locking up the market, adding an unwarranted level of uncertainty to a market that is on its way to normalizing." Div. Ex. 39. Ortiz noted that they had reduced Fund prices and expected to get to the $30 million inventory limit in an orderly manner in ninety days. Id. Ubinas followed up with an e-mail to Michel, Ortiz, and Belaval, stating that Ortiz had been forced to tell FAs that the Trading Desk was not buying Fund shares and Ubinas was concerned that this would snowball into a wave of sell orders. Id. By April 28, 2009, the Funds inventory was below $30 million. Tr. 762-63; Ortiz Ex. 316.

On May 19, 2009, the Risk Committee, chaired by Naratil, considered the following:

> Michel informed the Committee on the status of the initiative to print NAV information on client statements and confirms for Puerto Rico Closed end Mutual Funds.

> Michel stated that the proposal for changing the process to send out Fund brochures to all existing clients, as well as new purchasers of Puerto Rico Mutual Funds in the secondary market was on track.
>
> Price reported that measures undertaken by the government of Puerto Rico are on track and the economic outlook is now seen as "stable" by all rating agencies.
>
> The improving economic background has helped reduce the bid-NAV spread for Puerto Rico Closed-end Mutual Funds as the funds' NAV have developed positively in April. The Puerto Rico Capital Markets Group has significantly reduced inventory level and mutual fund positions no longer exceed their limit ($28mm on May 18th).
>
> In order to promote more rational pricing and more clarity to clients, Price and Michel suggest introducing a released limit of $12mm (in addition to the existing approved limit of $30mm) for the Mutual funds inventory. The rationale for this is that a significantly lower inventory limit will create the need for a more immediate reaction of prices to changes in supply and demand and therefore will increase transparency of the pricing process.[40]

Div. Ex. 49; see also Tr. 2555-61.

Setting the inventory limit at $12 million with a temporary cushion up to $30 million, which UBS used for municipal securities, was Naratil's recommendation and it was adopted by the Risk Committee. Tr. 2608-10, 2639-41, 2646, 2650; Div. Ex. 49; Ortiz Ex. 408. Price supported the decision because it facilitated Switzerland's request to reduce inventories. Tr. 2558, 2610. Price testified that Michel was responsible for working with Puerto Rico to implement the reduction to $12 million in inventory, and Price depended on Michel, Hausmann, and Ortiz. Tr. 2565-69; Div. Exs. 46, 49. The UBS Risk Committee and Executive Committee agreed on this course of action, and it was non-negotiable. Tr. 2609-10, 2651. Price expected the Trading Desk to reduce prices and that UBS PR had to make investors aware that the Funds provided good yields compared to other investment and at the same time lower prices. Tr. 2608-09, 2652.

On May 22, 2009, Ubinas e-mailed Price with a copy to Ortiz, thanking him for an update on the Risk Committee's discussions. Div. Ex. 125. In his response to Price, Urbinas tried to convey that a $12 million trading cap on a $5 billion Funds market was intuitively too low, the Funds' inventory reached $50 million only once in its history, and, due to the trading fluctuations, a $12 million inventory limit would almost invariably be missed during the month. Tr. 2879; Div. Ex. 125; Ortiz Ex. 328. With respect to NAV, Ubinas e-mailed Price that he believed that the basis on which the Funds' market traded was correct. Tr. 2886; Div. Ex. 125;

[40] The Risk Committee had determined that $12 million was the historical average of month-end inventories for the Funds. Tr. 2876.

Ortiz Ex. 328. Ubinas believed that if you sell a product to a client in an IPO, you have to support that product in the secondary market. Tr. 880.

Price testified that UBS PR played no role in the decision to reduce inventory. Tr. 2566, 2608-10. Ubinas and Ortiz were surprised that UBS PR was not consulted on a decision of this magnitude, especially where Ortiz had the most expertise with the Puerto Rico Funds market. Tr. 2567, 2890.

Naratil's response to Ubinas's push back on the $12 million inventory limit was to tell Price to stay firm.[41] Tr. 2648-50; Ortiz Ex. 328.

On May 29, 2009, Michel e-mailed Ortiz:[42]

> after the decision to implement a released limit of $12mm in addition to the existing approved limit of $30mm for Puerto Rico Closed End Mutual Funds, I would like to discuss with you the implementation plan for how to reduce our inventory to a level of below $12mm and a reasonable time frame for this reduction program.

Tr. 788-89; Div. Ex. 120; Ortiz Ex. 332. Ortiz's reaction was that this could not be a serious initiative and it was a very bad business decision. Tr. 458, 463, 791; Ortiz Ex. 332. Ubinas and Ortiz were of the view that inventory levels should "achieve the local market place goals of i) an adequate level of liquidity, and ii) price stability . . . ." Tr. 460-61; Div. Ex. 125. The term release limit meant that UBS PR had to reduce the Funds' total inventory to $12 million, which Belaval, Ferrer, Ortiz, and Ubinas thought would cause volatility and adversely affect retail customers, the Funds' principal market, and cause customers to lose confidence in UBS PR. Tr. 136, 174-75, 790-91, 2911.

It was at this time that UBS's position on inventory limits changed completely; flexibility in temporary limits was gone and weekly limits were mandated. Tr. 757-58, 786. The Risk Committee received daily reports on inventory levels. Tr. 758. Reducing inventory by $4 million each month added stress to a market that already had too many sellers, but it was doable and UBS PR did it. Tr. 130-31. When Ortiz saw that the UBS CFO was included on e-mails discussing the Funds inventory, it confirmed his belief that Naratil was behind the changes. Tr. 793.

---

[41] Ubinas testified that a $12 million trading cap on a $5 billion market was intuitively too low. Moreover, the Funds' inventory reached $50 million only once in its history, and due to the trading fluctuations, a $12 million inventory limit would almost invariably be missed during the month. Tr. 2879.

[42] Price called Ubinas on May 22, 2009, and informed him of the Risk Committee's discussion about a $12 million inventory limit for the Funds. Tr. 2875; Div. Ex. 125; Ortiz Ex. 328. Ubinas was not sure that the decision had already been made. Tr. 1234-35, 2877; Div. Ex. 125.

On May 29, 2009, Ubinas e-mailed Michel, Belaval, and Ortiz, with copies to Price and Ferrer:

> To reduce prices to a level that would bring the inventory to below $12 million at this time would indeed cause the "panic" you reference. Moreover, any such "forced" adjustment to prices would likely create major market disruptions as the yields on the funds would soar and all other locally traded securities would have to adjust in price causing major losses to both fund investors and holders of other local securities. I am sure no one intends for that to happen. [Belaval] and [Ortiz] have managed this inventory successfully and with great care and consistency over the last 14 years even in times of stress, achieving the local market objectives of liquidity and price stability at, we believe respectfully, acceptable risks to the firm in the light of the profitability of the business.

Tr. 465-66; Div. Exs. 41, 120. Ubinas told Ferrer that he and others were trying to convince Price not to force UBS PR to liquidate inventory. Tr. 1238, 1483-84. Ferrer testified that he first became aware of the situation at a meeting in Ubinas's office where he was made aware that UBS was considering a new policy with a $12 million limit, and that he heard from an FA that the Trading Desk was not providing bids because it was reducing inventory. Tr. 1447, 1484.

Still, UBS required UBS PR to reduce inventory to $12 million in a very short time. Tr. 175-76. UBS PR did so by lowering the prices of most Fund shares, which Belaval and Rosado testified was the only way it could accomplish the inventory reduction in a short time. Tr. 136-39, 977-78. To sell Fund shares from inventory, UBS PR had to fix Fund prices below the lowest pending GTC executable offer to sell when there were a lot of customer executable sell orders. Tr. 139, 466-69, 939-40. Whenever the Trading Desk lowered its firm bid below the lowest open executable offer, the offers to sell above the new bid level became nonmarketable or no longer executable.[43] Tr. 941-42, 963-64, 975.

Price was not aware of any formal announcement or disclosure by UBS to FAs or customers in Puerto Rico about inventory reductions and reducing Fund prices. Tr. 2582, 2584-86. According to Price, firms typically do not give notice to the market about what they are doing on their Trading Desks. Tr. 2582. Ferrer did not know for a fact that UBS PR or FAs disclosed to investors in May through August 2009, that it was reducing inventory, but he knew that the FAs knew about it because they told him they knew. Tr. 1237-38. Belaval recalls that UBS's decision to limit the inventory amount to $30 million and not allow the increase to $50 million was communicated to the BOMs and disseminated to FAs, but there was no official communication when UBS reduced inventory to $12 million in May 2009. Tr. 177-78, 254-57. Ortiz does not recall that UBS PR ever communicated to customers that UBS ordered an inventory reduction. Tr. 473. Pluchino's investigative testimony was that "there wasn't communication from senior management to the field regarding this particular reduction and risk position." Tr. 2469. The evidence is that UBS PR did not make a formal disclosure to FAs or clients in 2009, that it was reducing some Fund share prices below open GTC orders to accomplish an inventory reduction to $12 million. Tr. 145, 176, 254-57.

---

[43] This result always occurred.

Ferrer testified that he recalled that Price expressed concerns that the premium over NAV on Fund shares added risk to inventory levels, that Price told him UBS was reducing risk globally, and that UBS PR's inventory was too high. Tr. 1164-75. Ferrer recalled being on a conference call during which the $12 million inventory limit was discussed and he told Price and others it was idiocy, wrong, and would have distressing results for UBS PR's clients. Tr. 1170-73.

Rosado got the Funds' inventory down to $12 million "[t]he same way [he] got from 50 to 40, being the lowest offer price in the market." Tr. 938. The reductions in share prices needed to reduce inventory lowered the value of Fund shares held by investors. Tr. 467. Rosado disagreed with the decision to reduce prices and thought it a little bit unfair because, given time, the market would have come back into balance. Tr. 939-41, 977. Ferrer heard from FAs that the Trading Desk had stopped buying Fund shares; he thought it was because of the decision to reduce inventory to $12 million, and it bothered him because it meant UBS was not providing liquidity, which might concern clients. Tr. 1209-12. Ferrer testified that UBS PR's policy of providing liquidity for the Funds was maintained until the period following the Risk Committee mandated inventory sale in late 2009. Tr. 1018.

On June 8, 2009, Michel e-mailed Ortiz with a copy to Price:

> Juany – the Mutual Funds portfolio is nearly unchanged since more than a week now How is the initiative to get into the new released limit developing?
>
> I still think that lowering inventory levels in a controlled way by about $1 mm per week is reasonable and should keep us from running into severe issues with our clients. (The recent reduction from $50 mm down to the current $23.5 mm was actually done much faster)
>
> Effective today, I'll reduce the release limit from $30 mm to $24 mm. This does not have an immediate effect as you are already below this limit I suggest the following steps going forward:
>
> Effective Friday this week, we'll reduce the released limit to $32 mm Going forward we'll reduce the limit every Friday by $1 mm.
>
> This gets us to an overall timeline of three months to get down to the agreed upon $12 mm. Could you please make sure that the released limit of $24 mm gets reflected in the daily position reporting.

Ortiz Ex. 339; see also Tr. 795. Ortiz interpreted Michel's e-mail as pressure. Tr. 795. Ortiz testifies that the weekly limit was new and did not work in the Funds' market that experienced intra-month swings. Tr. 795. Ortiz tried to make Michel and the Risk Committee understand that they had made a bad business decision and, at the same time, had to follow instructions. Tr. 797.

Ortiz emailed Michel on June 9, 2009, describing the various steps the Trading Desk took to reduce inventory. Ortiz Ex. 339. They included buying from customers a minimum amount of shares, lowering bid prices to keep ahead of any open client orders in terms of lowest offer market price, evaluating differential pricing, and informing FAs that clients who wanted to immediately sell their reinvestment shares ran the risk of not having their sell orders executed immediately. Tr. 469-70, 797-99, 2578-81; Div. Ex. 44; Ortiz Ex. 339. Ortiz sent copies of the e-mail to Price, Ferrer, Ubinas, and Belaval. Naratil and additional legal staff were later added to the discussion in the e-mail chain. Ortiz Ex. 339. No one indicated to Ortiz that he should not take the actions he described. Tr. 799.

During this time period several people including Ortiz, Michel, Price, Culnan, Brent Taylor and Andrea Wolff in Legal, and Pluchino, received daily reports on the Funds' inventory. Tr. 794; Ortiz Ex. 338. In his investigative testimony, Pluchino testified he was unaware of how the Trading Desk was going to accomplish the reduction. Tr. 2465.

According to Price, the Risk Committee was balancing UBS, AG's request for its global business to reduce risk and concerns about the sovereign risk in Puerto Rico. Tr. 2571. Price was not very concerned about the impact reducing inventory had on Fund investors because they were typically long-term, yield-oriented investors and the yields were very good compared to the stateside municipal market. Tr. 2572-73. Price attributed the huge short-term influx of selling in Fund shares primarily to the general economy; his focus was on accomplishing the reduction in an orderly manner. Tr. 2573-74. Price is not aware that UBS notified Fund customers that it had directed a reduction in the Funds' inventory or of the possibility of a period of volatility in Fund prices. Tr. 2578.

On June 17, 2009, Ortiz e-mailed Michel with copies to Culnan, Belaval, Ubinas, and Ferrer:

> You should note, as I mentioned in our telephone conversation today, that clients and FA's are very concerned with this mandate, as they perceive that (i) UBS will no longer act as a principal but only as an agent in providing liquidity in the market and (ii) price volatility has increased dramatically and frequent price declines have resulted. Thus, we may not see the customary month end client purchases this month.
>
> (I believe we should consult legal-Compliance on the need to clearly inform the market of our change in practice regarding funds trading.)
>
> . . .
>
> Thus, I request that the mandatory weekly $1 million reduction in our funds position limit not be imposed . . . .

Ortiz Ex. 341; <u>see also</u> Tr. 801-03. Price, Naratil, and Weisberg agreed that the decision to reduce inventory from $30 million to $12 million did not need to be disclosed. Tr. 2623, 2627, 2654-55. Ortiz testified that he told FAs that the Trading Desk had to reduce inventory. Tr. 801.

On June 19, 2009, Ortiz e-mailed Michel with copies to Belaval and Ubinas, who shared his views, and Culnan. Tr. 803-04, 2898; Ortiz Exs. 342-43. Ortiz stated that the Trading Desk had reduced Fund prices significantly that month to try to reduce inventory by $3 or $4 million, however, inventory did not drop significantly because Fund customers had lost confidence that the firm would support the product, something about which Ortiz and Ubinas had warned. Tr. 472-73, 805; Div. Ex. 15; Ortiz Exs. 342-43. Ortiz noted that FAs complained that they did not understand how UBS can expect to manage a market with a $5 billion capitalization with severely reduced position limits, potential loss of value in accounts, margin calls, and that the changes are not clearly communicated to the sales force. Ortiz made three recommendations:

1. Stop the plan to drastically reduce inventory positions in a short time;

2. Focus on the 6 Funds that account for 75% of inventory positions; and

3. Amend trading policies so that a sale of reinvestment shares has the last priority.

Tr. 804-08; Ortiz Ex. 343. Ortiz testified repeatedly that market imbalances occurred in some, not all, Funds, although he agreed that there was a general drop in demand for the Funds from June 1 through June 18, 2009. Tr. 472-73. In his June 19, 2009, e-mail to Michel, Ortiz states that the month's trading volume through June 18, 2009, was 1.5 million shares, or about 13% of the average trading volume of the 3 prior months. Tr. 473; Div. Ex. 15 at Bates 7728.

Belaval testified that FAs knew that UBS PR had been instructed to reduce its Funds inventory. Tr. 174-76. Belaval did not communicate with all FAs directly, but he was candid when he spoke with FAs so that most FAs received the information via the grapevine. Tr. 176-78, 254-55. During this period, Belaval believed that trading volume went from about 50 million to about 30 million shares a month. Tr. 147. Belaval knew that customers and FAs were unhappy about the lower bids for Fund shares, and FAs were upset that management was telling them to advise clients to buy shares but UBS PR was selling shares. Tr. 178-79.

On June 22, 2009, Ferrer e-mailed Ubinas and Belaval that they needed to emphasize for Ortiz "the crisis as a consequence of the 'trading' policy changes to the Funds." Div. Ex. 78A.

UBS PR did not extend margin against Fund shares but at least one bank did. Belaval feared that Fund investors would receive margin calls and this would result in additional selling of Fund shares. Tr. 147. On June 24, 2009, Belaval requested that UBS Credit Risk Control consider reducing maintenance from 30% to 20% for Fund customers. Tr. 146-47; Ortiz Ex. 347. Belaval noted that recent municipal offerings and efforts to reduce inventory had reduced Fund prices significantly. Ortiz Ex. 347. Ferrer made the same request of Price on June 25, 2013. Tr. 1244-45.

Meeting minutes of the July 8, 2009, of the Risk Committee meeting state:

> Since May 22, inventory was reduced by $10mm, or 37%, which was achieved primarily by lowering prices across the board.

. . .

> While on average the spread between NAV and bid prices was reduced, some funds with higher volumes still trade at a significant premium to NAV.
>
> . . .
>
> [Price] informs the Committee about a concern raised by some Puerto Rico FAs about UBS's support of the mutual funds going forward. No statements have been made by the managers and FAs are making assumptions based on the recent decline in prices. FAs are deducing that UBS is decreasing its inventory levels and are questioning whether UBS will support the funds in the future.
>
> . . .
>
> The Committee agrees that FAs in Puerto Rico should be educated on UBS's position towards the funds.

Div. Ex. 52.

On July 28, 2009, Ferrer e-mailed Price with copies to Hoekstra and others, requesting a return to the prior inventory policy. Div. Exs. 8 at Bates 0916, 51 at Bates 5432. In response, Price indicated that the purpose of the inventory reduction was to bring the bid price more in line with NAV and reduce risk exposure. Tr. 1248; Div. Ex. 8 at Bates 0916. Ferrer replied that he did not know that the purpose of the inventory reduction, which necessitated lowering the price of Fund shares, was to reduce spreads of prices over NAV and that it had caused "huge losses to our clients and to our P&L." Tr. 1249-54; Div. Ex. 8 at Bates 0915. Hoekstra doubted Ferrer's claim of huge losses, asked for an internal review, and opined that the market should determine any premium or discount. Tr. 1249-54; Div. Ex. 8 at Bates 0915. On July 31, 2009, Ferrer responded to Hoekstra and Price, noting that prices came down when new trading policies were established. In an attachment, Ferrer showed that from May 1, 2009, to July 31, 2009, the Funds lost about $250 million in value, which Ferrer considered huge. Tr. 483-84, 1249-51; Div. Exs. 8 at Bates 0915, 40.

Ferrer does not believe that the reduction in prices shows that Fund prices had been overvalued:

> The sale of these shares over a period of a short period of time and having to undercut client orders, created, in my opinion, a spiral of reduced prices that led us to what we're discussing. That should not have been – that would not happen in a normal marketplace.

Tr. 1257.

The bid price of every Fund dropped between March 3, 2009 and September 30, 2009, and aggregate inventory appears to have fallen from around 5 million shares to close to 1.5 million shares Tr. 484; Ortiz Ex. 379. Trading volumes (buys and sells) went from a monthly 15.5 million shares in 2008, to 10.6 million in May, 2009, 5.6 million in June 2009, and 3.3 million in July 2009. Div. Ex. 40 at Bates 1550.

UBS PR reduced its inventory to about 11.9 million on August 3, 2009, accomplishing the mandatory reduction. Tr. 2656-57; Ortiz Ex. 353. In mid-August 2009, UBS eased the pressure on UBS PR to reduce inventory. In September or October 2009, UBS restored UBS PR's previous inventory limits. Tr. 1252-53.

Meeting minutes of a September 11, 2009, Risk Committee meeting state that Fund inventory was reduced in July and August and was now in line with a $12 million limit and the reduction was achieved primarily by lowering prices across the Board. Tr. 2588-90; Div. Ex. 53 at Bates 5450. The minutes continue that NAVs rose in July and August supported by a stable Puerto Rico economy, and the spread between bid prices and NAV was reduced to 10%. Also, the Trading Desk is "reviewing more market sensitive pricing approaches including exchange concepts with other Puerto Rico firms and using external pricing vendors." Div. Ex. 53 at Bates 5451; see also Tr. 2588-91.

In October 2009, Price, Naratil, and Hausmann came to Puerto Rico, told Ortiz he had flexibility in managing the market, reinstated the previous inventory limits, and assured the top FAs that the firm supported the Funds 100%. Tr. 809.

GTC orders

The Trading Desk maintained a GTC book. Tr. 307. The FAs began having access to the GTC book on February 24, 2009; the GTC book was never shown to customers. Tr. 307-08, 389, 392, 731-32, 871-72, 961-62; Div. Ex. 56; Ortiz Ex. 284.

Date	Value of Funds' Inventory	GTC Book Executable Sell Orders[44]
May 5, 2008	$31,360,826.08	$8,927,193.90
June 2, 2008	$37,981,937.06	$8,738,681.55
July 7, 2008	$40,426,761.26	$6,423,070.00
August 1, 2008	$39,730,034.05	$3,669,326.10
September 2, 2008	$27,203,495.09	$2,036,200.00
October 6, 2008	$41,505,513.10	$5,949,975.86
November 3, 2008	$45,086,928.10	$5,043,007.50

[44] These sell orders were at or below UBS PR's bid price. Tr. 444.

December 1, 2008	$41,413,193.05	$798,202.35
January 5, 2009	$44,292,429.92	$5,696,751.50
February 2, 2009	$41,202,936.18	$5,443,514.50
March 2, 2009	$46,932,210.04	$11,619,292.41
April 6, 2009	$39,567,560.58	$16,031,219.28
May 4, 2009	$26,603,537.07	$1,948,786.26
June 8, 2009	$23,439,469.96	$2,072,637.00

Div. Ex. 56.[45] Buys and sells occurred throughout the period, but the large amount of executable GTC orders indicates more sellers than buyers. Tr. 901, 906, 911, 925, 929.

On February 24, 2009, the Trading Desk began sending the GTC book to FAs daily, and whenever a price change occurred. Tr. 735; Ortiz Ex. 284. The GTC book showed orders at or better than what UBS PR was offering (marketable open orders). Tr. 732, 735. Ortiz testified that he had wanted to provide FAs with this information since June 2008, and that doing so led to more orders. Tr. 732, 742. On March 3 and 4, 2009, the Trading Desk had total sell orders above the bid price of $7,590,464.89 and $22,862,048.28, respectively. Tr. 446. To assess the impact of reduced prices, on March 5, 2009, Ortiz directed the Trading Desk to show the impact of reducing Fund share prices right below the lowest sell order on the GTC book. Tr. 738; Div. Ex. 73.

UBS PR advice in 2008-2009

The price of Fund shares fell 10% to 12% between the summers of 2008 and 2009, the period of required inventory reductions. Tr. 141. Fund shareholders were distressed by the fall in value of their holdings, and competitors took advantage of the situation by criticizing UBS PR and poaching clients and FAs. Hypothetically, an investor who invested $100,000 in the summer of 2008 held shares that were worth $88,000 in the summer of 2009, but the dividend payments received over that period did not change. Tr. 185. This was not a happy period and UBS PR management spent an awful lot of time meeting with clients "trying to provide counsel and advice that they should not act inappropriately, and to understand what was going on, and hold on to their investments." Tr. 144. However, Asset Management believed that while the fair market value of Fund assets fell, the creditworthiness of Fund assets was strong and that adverse economic conditions at the time were only temporary. Tr. 2699-702.

Ubinas believed that in March of 2009, Puerto Rico was coming out of difficult economic conditions that had lasted for 4 or 5 years and that things were going back to normal. Tr. 2846-47. Also, the global problem that occurred in 2008 did not impact the fundamental value of

[45] Data for the first Monday of each month is included in this chart to show the progression of inventory compared to executable sell orders over the relevant time period. Because data for the first Monday of August and September 2008 was not available as part of Div. Ex. 56, the first available data for each month was used.

Puerto Rico municipal bonds, the Funds' assets, and they wanted to educate customers so they acted rationally, not emotionally. Tr. 2847-51. Ubinas believed that the drop in Fund NAVs was a temporary situation driven by emotion. Tr. 2856.

Ferrer believed that in 2008 and 2009, FAs were counseling clients that this was the worst time to sell and they should keep calm and retain their Fund investments. Tr. 1336. When UBS PR advised people to buy or hold their Fund shares, it did not disclose that it was reducing the price of Fund shares below open orders on the GTC book to reduce inventory. Tr. 258.

Belaval, bolstered by others in Wealth Management and UBS PR's fixed income analysts, believed that - because Fund prices were low - this was a good time to invest in the Funds, the external factors did not reflect the quality of the Fund assets, and customers should buy shares of the Funds because of their attractive yields going forward. Tr. 155-56. The Funds were paying dividends of approximately 8% at a time when Treasury bills or 1-year certificates of deposit were paying about 2% interest or less. Tr. 185. This was the message that UBS PR management was telling FAs to convey to clients. Tr. 156.

Belaval testified, "We were telling the people aggressively that they should be buying. We were telling people that had funds that they should not be selling." Tr. 145. UBS PR believed that: the low price and high dividend yield made the Funds a good investment opportunity; on a risk-adjusted basis, the Funds had in the past proven to be very good investments; and the Funds were unique investments that studies showed had positive returns over any 5-year period.[46] Tr. 183, 197-99, 226.

At the UBS PR 2009 Investor Conference, an annual event to provide FAs and investors with information, Ferrer greeted participants, and Ortiz made a presentation about the Funds. Tr. 486-87, 766, 771-75, 1183-86. Ortiz saw his role as presenting historical information about the secondary market for the two principal investments in Puerto Rico - municipal securities and closed-end funds, their liquidity and price stability. Tr. 765, 772. Ortiz's PowerPoint presentation defined liquidity as the degree to which an investment can easily be sold or converted into cash, and showed Fund trading volume as $870 million in 2006, $814 million in 2007, and $1,176 million in 2008. Tr. 1186-87; Div. Ex. 21 at Bates 0071, 0073.

Ortiz did not mention: (1) the market imbalance that existed in various Funds from May 2008 to March 31, 2009, or (2) its parent's directive to reduce inventory. Tr. 492; Ortiz Ex. 304; Div. Ex. 21. The presentation showed trading volumes in Fund shares for 2006, 2007, and 2008. Tr. 489, 772-73; Div. Ex. 21 at Bates 0073. Ortiz testified that at the end of his presentation, he told the audience that the secondary market went through periods of illiquidity. Tr. 775.

In his investigative testimony Ortiz stated that he referenced trading volume under liquidity in his presentation so that they "can better understand the degree to which they can sell

[46] Belaval testified that the Funds would not be a good investment in periods where the yield curve was inverted because high short-term interest rates would impact leverage and reduce yield. This has only happened once since 1995. Tr. 183-84.

their investments."[47] Tr. 491. The use of trading volumes was the only presentation showing Fund liquidity. Tr. 491. The presentation also stated that (1) UBS PR experienced consistent levels of Fund trading in 2008 and (2) the Funds "experienced a small price increase from January 2007 to February 2009 despite challenging conditions in U.S. municipal and closed-end fund markets." Tr. 491; Div. Ex. 21 at Bates 0076. The presentation showed the Funds' weighted average price had not dropped because while many Fund prices had fallen, the price of AAA Funds, which are the largest had increased. Tr. 492-93.

Ferrer's *El Vocero* interview and communications to FAs

On April 24, 2009, *El Vocero* published an interview with Ferrer with a picture and a quote, "I believe we have touched bottom although it may go down before coming up. But we already know that there are true buyers at certain levels." Div. Ex. 80:

> 'The Puerto Rican investor has suffered relatively little or very little from the international disaster, and we can say that we didn't even catch a cold.'
>
> . . .
>
> 'Local mutual funds have had an excellent yield throughout this process,' explains Ferrer. But despite this, many investors call scared, because of the news about the lows in financial markets, 'when in reality that news does not have any relevance to the investor. In general, the Puerto Rican investor that has his/her money invested in bonds and mutual funds has obtained fantastic results.'
>
> Local mutual funds have had results over the years comparable to [equities]. 'The result of an investor in local mutual funds who has been able to reinvest the dividends has been higher, and in some cases, comparable to the market of [equities] Index,' says Ferrer, and assures that this type of investment offers much less volatility, and good relative results.
>
> [']This does not mean that each investor should not look at his/her particular situation, and adjust his/her decisions to the risks he/she is willing to consider,' warns the executive. 'But having said that, in general terms, the Puerto Rican investor has not been involved in the crisis.'

Div. Ex. 80; see also Tr. 1226-29.

The record contains memos and e-mails from Ferrer to FAs going back to 2005 that are similar to those at issue. Tr. 1384-1401; Ferrer Exs. 530-535. Ferrer testified that his communications were to focus FAs on things they knew, they were not sales material; he never withheld or misrepresented information. Tr. 1417-18. Ferrer testified that his e-mails were:

[47] It seems as if some of the investigative testimony was with the Commission and some was with FINRA.

> to give [FAs] comfort that the world was not going to end, that there was light at the end of the tunnel, that our products, in general, were doing relatively well, that the customers that held these products should hold onto them, and just don't read the newspapers; and that those that had funds available should avail themselves of the opportunity that was being provided by the instability of the markets.

Tr. 1384. Ferrer believed that FAs knew that his communications were for internal use only and were not to be shared with customers. He did not expect FAs to forward or repeat what he told them to customers, and never learned that they had done so. Tr. 1468.

On June 16, 2008, Ferrer wrote to the BOMs:

> All:
>
> June month is half over.
>
> You need to focus your sights in business that makes sense for our clients and our [FAs] with great yields and probably improving dividends.
>
> Our Funds make sense.
>
> Make certain that all FAs are aware.
>
> MAF

Div. Ex. 114; see also Tr. 225, 1034-36, 1414. Ferrer testified that Puerto Rico was in the second year of a recession and low interest rates were possible because of the Federal Reserve's actions. Tr. 1415. The purpose of the e-mails was to focus the BOMs on the Funds for those clients that are looking for products with great yields and improving dividends. He would not necessarily characterize it as marketing, but he hoped that UBS PR would create a market. Tr. 1035.

On the same day, Ferrer sent an e-mail to the FAs:

> If you wish to have your clients take advantage of great yields and even maybe improving dividends, see attached.
>
> Good things do not last long. . . .
>
> MAF/sq

Div. Ex. 119; see also Tr. 1032-33. An inventory sheet for June 16, 2008, was attached.[48] Ferrer testified the great yields were shown on inventory sheets, monthly dividend information, and

[48] Ferrer testified that he received inventory sheets from time to time. Tr. 1032-33.

quarterly reports he received and improving dividends were expected from declining interest rates. Tr. 1409-12. And that his purpose was to have the FAs notice the Funds' inventory with great yields so they could advise customers to buy or not to sell shares. It was well known that the Federal Reserve was lowering short-term interest rates, which meant the Funds could increase their leverage and pass on increased dividends to clients. Tr. 1033-34. One FA took the e-mail to mean it was a great time to invest in the Funds. Tr. 1664.

Ferrer wrote an e-mail to Ubinas and Belaval on August 29, 2008, that grew out of the group management meeting earlier in August. Tr. 1044. He wrote we have to "fix" this and to do so he suggested a unit within Ortiz's group that would: (1) generate the story about each Fund: (2) facilitate large crosses; and (3) work with traders to coordinate bids and offers. Div. Ex. 3. Ferrer testified that the group meeting participants thought some FAs did not have sufficient information to give clients about Fund differences and that is what he intended to fix. Tr. 1045, 1425-26. Fund differences included allocation among investment types, bond ratings, the amount of leverage, whether perpetual or target dates for closure, and different short-term risks. Tr. 2187-90. Ferrer proposed that the Trading Desk bid for at least $100,000 at any time, but others informed him this was unfeasible. Tr. 1046-47. Ubinas replied to Ferrer on August 29, 2008, that a multidimensional group headed by Ortiz would address the secondary market for Fund shares and indeed the entire Fund marketing effort. Tr. 1048; Div. Ex. 127.

On September 18, 2008, Ferrer e-mailed the FAs:

> All:
>
> In the midst of all the turmoil, I note the <u>superior performance of our local Funds</u>. They seem to be weathering the "Wall Street Storm" in pretty good fashion, which gives me great comfort.
>
> Thus, you should look at these for clients searching for low volatility and respectable returns.

Div. Ex. 81; <u>see also</u> Tr. 226, 1109.

One FA who received the e-mail took it to mean that the Funds were safe investments. Tr. 1644-45. Another took it to mean, look at this product and if it suits you, go sell it. Tr. 2038. A third FA did not interpret it as a directive to sell more Fund shares. Tr. 2803-05. On September 15, 2008, Lehman Brothers Holdings faced liquidation and Merrill Lynch & Co., agreed to be acquired by Bank of America. Ferrer Ex. 663. Ferrer wanted the FAs to know he understood they were going through hell. He wanted them to be comfortable and to give their clients comfort. Tr. 1438.

On September 23, 2008, Ferrer e-mailed the FAs:

> There is a certain comfort in owning our Funds; low volatility, attractive returns (in fact <u>very</u> attractive).

> Conclusion: Worth considering!!!
>
> Look at Fund VI…; it will presently provide good yields.
>
> MAF

Ferrer Ex. 559. Ferrer testified this message was based on the facts shown in the information he received on returns and volatility. Tr. 1438-39. Asset Management, which works on developing new funds projected that the Fixed Income Fund VI would have a very attractive yield based on the existence of assets with good yields and very low leverage costs. Tr. 2707-08.

On September 24, 2008, Ferrer e-mailed:

> Financial Advisors:
>
> It is our expectation that due to particular and favorable circumstances, Fund VI will promptly show attractive returns.
>
> I urge you to focus your efforts in what we expect will have stellar performance.
>
> MAF

Div. Ex. 35; see also Tr. 228-29. Ferrer's purpose in sending the e-mail was to give the FAs information to get them to look at the Fund to see if it was suited to their customers. Tr. 1111-13.

On September 29, 2008, Ferrer sent the FAs an e-mail that stated, in part:

> The unexpected (by me) outcome of Congress vote on the "Bailout" has shaken the markets across the World.
>
> . . .
>
> The good news is that our Funds are doing fine and our clients are not suffering unduly. So, being conservative has benefited our business.
>
> I foresee that our particular situation, good credit rating, good tier one capital ratios, will allow us to pick up more assets and more clients during this turbulent period. What is necessary is you transmit confidence and calm and pursue opportunities.
>
> MAF

Div. Ex. 115; see also Tr. 1117. Ferrer's intent was to urge FAs to keep calm during this horrible time for investors so that they could keep their customers calm. Tr. 1440-41. One FA testified that the e-mail pinpointed that the returns of the Funds were superior to other products and advised FAs to talk to their clients about the Funds and advise them not to sell. Tr. 2039.

On September 30, 2008, at 6:49 p.m., Ferrer e-mailed the FAs:

> Did you note that our Funds did not budge in the midst of all the bad news yesterday? Their low volatility and low coefficient to equities are a great reason to consider them as a timely investment. Plus their returns are superior! Need I say more?
>
> MAF

Ferrer Ex. 563.

An FA took from this message that what was happening to Lehman Brothers and Bank of America was not happening to Fund shares, and gave him comfort in recommending Fund shares. Tr. 1648. At 9:09 p.m. the same day, Ferrer sent a second e-mail saying, "We are not out of the woods, yet," and urging FAs to contact clients and offer their best advice. His e-mail also states, "In the meantime, all is well in Puerto Rico and our client base is enjoying the fruits of conservative investing." Tr. 1442-43; Ferrer Ex. 654. The House of Representatives rejected a bailout plan on September 30, 2008, that sent the stock market into a tailspin. Ferrer Ex. 664. During this period, the Funds were resilient; prices did not collapse. Tr. 1434-35, 1436; Ferrer Ex. 662. Ferrer testified that: (1) his statements were true based on information he had; (2) market turbulence and UBS PR inventory provided people with an opportunity to buy these good investments; and (3) FAs were trained to explain that these investments could be less than liquid and he believed they did so. Tr. 1118-20, 1442.

Ferrer also testified that there were no new risks to the Funds that were not known through the prospectus, brochures, and other information available to customers. Puerto Rico was in the third year of a recession but it did not impact the Funds. Tr. 1444. The portfolio values went down because some of the assets were downgraded, which caused some Fund shares to sell at a premium, but dividends were unaffected. Tr. 1145-46.

On November 6, 2008, Ferrer e-mailed the FAs:

> As I look at 2009, I need to alert you that the local new issues municipal market will probably be quite limited.
>
> Meanwhile, low short term rates should allow our Funds to produce very nice dividends. So, look at these.
>
> You may as well start now and join the fun early on.
>
> MAF

Div. Ex. 117; <u>see also</u> Tr. 1140-41. Ferrer intended to convey that low interest rates would benefit leverage opportunities and thus higher dividends, and he knew some FAs accumulated customer cash in expectation of bond offerings and his information was that bond deals were going to be limited. Tr. 1495. One FA interpreted the e-mail to mean that the only fixed income product available would be the Funds and they were a very good investment. Tr. 1665. The FA agrees that low short-term interest rates would produce nice Fund dividends. Tr. 1760. The FA sold Funds to clients because nothing else was coming to market and they produced nice dividends. Tr. 1665.

On December 5, 2008, Ferrer e-mailed the FAs:

> Needless to remind you of the very difficult times we have suffered through these past months and the pain that we still will have to live through the coming year.
>
> But we need to be thankful that our clients have pretty much been isolated from the desolation in the equities markets. Our Funds and local bonds have done well!
>
> We end 2008 with <u>record</u> net new assets, total assets under management, revenues and profits.
>
> . . .
>
> But the road will be bumpy and every one of you must strive hard, very hard and work smart, very smart to provide products and services of excellence to our clients. It is our clients that comprise our most valuable asset. Every effort must be spent in securing their wellbeing and satisfaction.
>
> . . .
>
> Thank you all for being great. Have a wonderful Holiday Season.
>
> Love you!
>
> Miguel A. Ferrer

Ferrer Ex. 570. Ferrer testified that the information was factual. The Funds had done well and Fund customers had not suffered from the desolation in the equities markets. Tr. 1463-64.

On December 19, 2008, Ferrer e-mailed Ubinas, Belaval, and Ortiz, "There are numerous complaints from [FAs] of lack of liquidity. This is not good." Tr. 1144; Div. Ex. 83. In response, Ortiz informed Ferrer:

> given conditions in the 103 market and the GDB deal, there is limited investors' focus in other products in the secondary market. We are trying very hard to provide the best liquidity possible at this time (in a fully transparent and fair way to investors).

Ferrer Ex. 571; <u>see also</u> Tr. 1465-67. Ferrer suggested that Ortiz provide the FAs with this information at the next week's sales meeting.

On October 8, 2009, Ferrer sent an e-mail to the FAs, which stated in part:

> When there are more sellers and few buyers, prices of all securities will decrease. Such is the situation with some of our Funds at times, to the extent there is little justification for their prices relative to yield.
>
> The reason is: more sellers than buyers at a given time. So what is the answer: <u>the opportunity to buy that particular Fund at great yields, because of a market dislocation.</u>
>
> Then the reverse will happen, demand will drive the price up to where it should have been all along.
>
> The conclusion: smart investors generally make out very well from the vicissitudes of others.
>
> Please choose the course of action you prefer.
>
> MAF

Div. Ex. 82; <u>see also</u> Tr. 232-33, 1121. Ferrer testified that he was reminding the FAs of what they knew, market imbalances presented opportunities to buy when things are cheap. Tr. 1454. One FA did not consider the information to be new and the message motivational. Tr. 2805-06.

Ferrer e-mailed the FAs on October 9, 2008:

> Eric Snyder asked me, why in heaven's name did you guys open a new Fund (VI) when there are plenty of old fund shares available in secondary market?
>
> There is one answer. Because it is our responsibility to provide our [FAs] with alternative different Funds to offer their clients, both old and new Funds.
>
> The Fund that fits the particular needs of each client is the decision of each [FA] to make. We provide the varied vehicles for each FA to choose among.
>
> So the answer in four words; <u>it's good for clients</u>!
>
> MAF

Div. Ex. 34. In this e-mail, Ferrer reiterated his position that people wanted to buy new shares of new funds because they sold at $10 per share with no premium, this new fund had a number of great portfolio possibilities, and low interest rates meant good leverage possibilities. Tr. 1123-25. His message was that this Fund was a good one to consider, but the FA was the only one who could determine a client's suitability. Tr. 1455.

Also on October 9, 2008, Ferrer e-mailed several of the FAs, stating in part:

> I am confident in a couple of year's time we will remember this historic period, not only for the enormous stresses, but also for the incredible opportunities it offered.
>
> It is important we all keep in mind that local investors have side stepped the wrath of the marketplace and have been enjoying superior returns from our Funds.
>
> So we have sustained some wounds, but remain totally able to go the next rounds, <u>hopefully good rounds.</u>
>
> MAF

Div. Ex. 116; <u>see also</u> Tr. 1137-38. Ferrer testified that his statement about the Funds' superior returns was factually correct. Tr. 1457.

Ferrer sent an e-mail to the FAs on January 27, 2009, about the Funds:

> These are our war horses!
>
> Do <u>not</u> forget they have been producing <u>very attractive</u> returns and we believe this trend should continue favorably for some time.
>
> Happiness today is a good return with low volatility.
>
> Our Funds are providing just that!!!
>
> MAF

Div. Ex. 84; <u>see also</u> Tr. 1153-54. An FA responded on the same day:

> I agree with you 100% regarding our Funds but where is the liquidity when the client needs his money urgently? I have an account (deceased client) trying to sell a Fund since December 15th with no success. I started with a bid of 9.70 and now is 9.04 and still waiting. The actual value of this Fund now is worth $20 M less for the widow in a period of one month. This particular war horse is not fighting when needed most by a client.

Div. Ex. 84; <u>see also</u> Tr. 1154.

On March 17, 2009, Ferrer e-mailed the FAs:

> You will find substantial demand for our Funds from IRA investors. Rest assured our IRA's based on Funds are very attractive choices for investors.

> So; do not be a Lemming, be a Lion! Start accumulating our funds now. Now; because the prices will probably be higher soon.

Div. Ex. 85; see also Tr.1155-56. Ferrer acknowledged that the purpose of the e-mail was to get customers to buy product. Tr. 1501, 1514. One FA understood it to mean that FAs should look for clients seeking IRA investments and offer the Funds to them. Tr. 1662. This FA did not believe the message. He did not advise clients to invest their IRAs in Fund shares because he saw the liquidity situation and was not sure clients would be able to get money for retirement if they needed it. Tr. 1662.

On March 26, 2009, Ferrer e-mailed the FAs:

> I urge you to go all out and call your clients, specially those you want to be there, because this will be a very important and timely conference.
>
> The information presented will offer comfort to holders of Puerto Rico bonds and Funds and hopefully provided you an opportunity to enhance your relationship with your clients attending.
>
> MAF

Div. Ex. 91; see also Tr. 1182. Ferrer acknowledged that the message was to have the FAs talk to customers about buying Funds, which had become eligible for IRA accounts. Tr. 1502, 1514. One FA took it to mean that the conference would give clients confidence in the Funds so they would not sell and buy more shares. Tr. 2041-42.

On the morning of April 1, 2009, Ferrer e-mailed the FAs that they heard the Funds' great story at the Investor Conference and they needed to make investors aware of this opportunity for IRA investments. Tr. 1181; Div. Ex. 86. In the afternoon, he e-mailed them about the Investor Conference:

> Wow! What a show. . . .
>
> Our clients received a huge dose of comfort on their investments, the right consideration in view of what; we believe the local market for bonds (and funds) is headed.
>
> This will offer you another opportunity to do right for your own client base by showing each client how he or she can benefit from the opportunities at hand.
>
> The ball is now in your court. (bold in original)
>
> MAF

Div. Ex. 87; see also Tr. 1199-1200. Ferrer sent this for the same reason he sent the prior exhibit. Tr. 1515. One FA understood it to mean that sales for RA was a source of 3% commissions, which was something new. Tr. 3024.

On April 24, 2009, Ferrer e-mailed a number of FAs his beliefs on the creation of value as it relates to the Funds:

> Many of you all have asked I touch you all with my understanding of The Creation of Value, as it relates to our Funds.
>
> This is not a theory; it is the appropriate answer to the premium that our Funds enjoy over NAV. The portfolio of assets provides the revenues; the leverage covers costs and provides the extra returns that allow very competitive yields through dividends to be paid. You add the reinvestment kickers and you end up with above market relative returns.
>
> . . .
>
> You should relate this to your clients.
>
> MAF

Div. Exs. 38, 126; see also Tr. 1217-22. Ferrer testified that he expected FAs to relate the contents of this e-mail to customers. Tr. 1503. Compliance asked Ferrer to add, "Investing in the Funds do carry risks. For a full discussion of the risks that you and your clients should be aware of, please see the information available on the UBS PR Funds website. [citation omitted]" to this and future e-mails. Div. Ex. 126. Ferrer quickly re-sent his e-mail with the language Compliance suggested, although he told Compliance he thought it was unnecessary. Tr. 1476. Pluchino testified that Compliance regularly reviewed the e-mails of senior management, which Ferrer was aware of. Tr. 1477, 2483. Pluchino contacted Ferrer on this e-mail because, while it was factually accurate, it told FAs to relate a message to clients and FAs are required to relate benefits and risks. Tr. 2484. Ferrer included the sentence in some future e-mails but not all of them, especially where they did not mention the Funds. Tr. 1481. One FA testified he would have wanted to know at this time that UBS had expressed concern over the premium over NAV in the price of Fund shares because it would have meant "there was something going on with the pricing of the funds." Tr. 1650.

On May 14, 2009, Ferrer e-mailed the FAs:

> This is a big business opportunity!! Billions are ready to roll-over during 2009.
>
> You can offer attractive investment alternatives for many IRA investors; our Funds.
>
> MAF

> PD Investing in the Funds do carry risks. For a full discussion of the risks that you and your clients should be aware of, please see the information available on the UBS PR Funds website. [citation omitted]

Ferrer Ex. 594; see also Tr. 1503. Ferrer testified his message was to sell more IRA investments to customers. Tr. 1504.

On August 3, 2009, Ferrer e-mailed the FAs:

> Have you noticed our Funds have continued to pay dividends monthly and in many instances in increasing amounts to provide pretty good yields?
>
> In our local market paying dividends is quite an accomplishment.
>
> Think about it! And consider the present prices of our Funds.
>
> Is this an opportunity to consider Funds for long term investments?
>
> MAF

Div. Ex. 88; see also Tr. 1258-59. Ferrer testified that the FAs and everyone else knew that Fund prices had dropped. He viewed this as an opportunity to buy. Tr. 1517. An FA testified that when he read this e-mail he would have liked to have known that the Trading Desk was reducing prices because it would indicate that prices were not being set by supply and demand. Tr. 1656-66. Another FA testified that he would have wanted to know when selling the Funds that UBS PR had changed its traditional policy of facilitating the Fund market, that it had reduced Fund prices to reduce inventory, or that it was purchasing the minimum shares possible. No one provided him with this information. Tr. 2048-49.

Ferrer considered it an FA's responsibility to inform clients that the Funds are long-term investments since, at times, they have limited marketability. Tr. 1330. To make this point, Ferrer testified that UBS PR penalized FAs on their commissions if clients sold Fund shares in less than a year without a specific very detailed reason. Tr. 1331, 2034. Ferrer testified that this May 3, 2009, e-mail was the first one he sent to FAs about the Funds after learning of the inventory reduction to $12 million, and that it was factually accurate as the Funds had increased dividends while local banks had stopped doing so. Tr. 1487-88. Ferrer believed the Trading Desk had completed the inventory reduction to $12 million by August 3, 2009. Tr. 1490.

On August 11, 2009, Ferrer e-mailed the FAs:

> I call your attention to the very attractive yields available in our various Funds.
>
> In the interest rate environment being expected over the next year (or longer), it is pretty hard to find an instrument that offers comparative tax-free returns.
>
> "It is the valiant that rise to the occasions." (anonymous)

MAF

Div. Ex. 89; see also Tr. 1262.

On August 13, 2013, Ferrer told a producing BOM that Ortiz "may be once again more effective in the Funds, which should translate into more demand, which should translate to prices more in accordance with their yields and with the rest of the local bond market." Tr. 1265; Div. Ex. 77.

Ferrer acknowledged that his e-mails did not disclose that: (1) prior to August 3, 2009, the Trading Desk had reduced the price of Fund shares; (2) at the time, investors who held the Funds had suffered large paper losses; (3) UBS had changed the policy on inventory that had been in place for some 15 years. Tr. 1505-06, 1511-12.

Public Witnesses

Division evidence from FAs and investors

Basil Davila

Beginning in June 2005, Basil Davila (Davila), an attorney with a Master's degree in Tax, invested $6 million or $7 million in the Funds on the recommendation of an FA. Davila told the FA that he wanted a safe investment to generate income for living expenses until he could find a suitable real estate investment. Tr. 1520-22, 1532-33, 1541; Div. Ex. 106. Davila practiced corporate tax law from 1968 to 1981. Tr. 1541-42. Davila had four accounts at UBS PR, one in his name, one his wife's name, and two in the names of personal corporations. Tr. 1545. The FA told Davila the Funds were a good investment; had been around for some time; their value had either been retained or increased; they generated 6% or 7% in annual income; and you could buy and sell them. Tr. 1522-23. Davila did not know about closed-end funds, which he understood these Funds to be. Tr. 1522. The FA recommended Puerto Rico Investors Tax Free Funds (PRITFF) and together they chose six PRITFF Funds and the Tax Free Puerto Rico Fund Inc. Tr. 1521-22, 1532. Davila recalls receiving a brochure about the Funds after he invested, he does not recall receiving a prospectus. Tr. 1546-52, 1555-56; Div. Ex. 24, Ferrer Ex. 505.

Davila believes he sold a substantial amount of Fund shares in 2007, and he sold $2.8 million of Fund shares in 2008 and $2.3 million in 2009. Tr. 1534-35, 1551-52; Div. Ex. 106. Davila testified that only half those amounts were his because he had a line of credit. Tr. 1535; Div. Ex. 106. Davila's records show that he lost $142,351.94 and $250,512.66, respectively, on his 2008 and 2009 Fund sales. Tr. 1535.

Selling the Funds was difficult in 2008-2009, and Davila had to lower his selling price. Tr. 1536-37. Between March and May 2009, when he sold approximately $2.5 million worth of shares, Davila had had to wait a week or much longer to sell and had to reduce his price. Tr. 1553-54, 1556. According to the FA, the difficulty in selling shares was because there were no buyers. Tr. 1537. The FA did not tell Davila that in 2009, UBS PR was dropping its prices and selling inventory. Tr. 1538. Davila does not think the FA misled him. Tr. 1555.

Gustavo Del Valle

Gustavo Del Valle (Del Valle) was an FA at UBS PR's Guaynabo branch with about 40 clients, less than half of whom invested in the Funds, from July 2006 until he was terminated in November 2010 for low production.[49] Tr. 1558, 1560, 1657-58, 1710. Prior to UBS PR, Del Valle was with Citigroup Smith Barney for 10 years. Tr. 1559. UBS PR provided Del Valle training about the risks in owning Fund shares. Tr. 1563, 1702. Del Valle agrees he must have attended a presentation by Legal & Compliance on June 19, 2007, that included a checklist of items to be covered with clients, including an extensive discussion of the possibility of illiquidity. Tr. 1702-10, 1765-66; Ortiz Ex. 231. Del Valle testified he was never instructed to inform customers about the risks of Fund ownership, but he also testified that he was familiar with the disclaimer in the Funds' prospectuses and knew he had to tell clients about it:

> No assurance can be given as to the liquidity of, or the trading market for, the Shares as a result of any activities undertaken by UBS PaineWebber Puerto Rico. Such purchases and sales, if commenced, may be discontinued at any time.
>
> If any time UBS PaineWebber Puerto Rico (and other dealers, if any) ceases to maintain a market, the Shares will become illiquid until a market is reestablished.

Ferrer Ex. 515; see also Tr. 1564-6, 1568, 1691-93, 1701.

Del Valle testified he and other FAs received the Family of Funds' brochure attached to a memo dated February 4, 2008, which stated in two places that UBS PR is not obligated to maintain a market in the Fund shares and therefore customers may be unable to sell. Tr. 1695-1701; Div. Ex. 123 at 3, 7; Ferrer Ex. 543 at 3, 7. Del Valle acknowledged that the 2008 brochure stated prices were determined by how much buyers are willing to pay or sellers are willing to accept and how the Fund is performing compared to other investments and not by NAV. Tr. 1699-1700. However, his investigative testimony is that he did not see the 2008 version of the brochure but he did see the 2009 version. Tr. 1775-77.

Del Valle attended a meeting in 2006 where Rosado went over Trading Desk procedures and advised that during periods of limited liquidity it was important for FAs and CFAs to disclose to clients the possibility that there may be a delay in order execution and the price received may differ from current Trading Desk price. Tr. 1573-7; Ortiz Ex. 227. Del Valle

[49] Del Valle's clients had less than $ 1 million in AUM. Tr. 1560, 1711. Del Valle was put on notice that he might be fired in February 2009. Tr. 1669. He testified that a FINRA arbitration panel awarded him a total of $600,000 on his claims that UBS PR discriminated against him because he had contacted the Commission in March 2009 to complain about how the Funds were being handled and because of a health issue. Del Valle has a whistleblower application pending with the Commission, which could result in a financial payment, citing his participation in this proceeding. Tr. 1658-61, 1673-79; Ferrer Ex. 659.

understood temporary illiquidity to mean that order execution would take no more than 1 or 2 days. Tr. 1575. Del Valle testified Ferrer and others showed FAs how to give a hand signal that seemed to indicate the FA was charging 1% not 3% as a commission. Tr. 1623-26, 1760-61. Del Valle first mentioned the hand signal at an arbitration hearing in May 2012, where he said it was an office joke. Tr. 1762. Del Valle's experience was that sales confirmations sent to clients did not disclose commissions, which was supported by the testimony of another FA. Tr. 1626-27, 2036; Div. Ex. 112.

From mid-2008 through 2009, illiquidity in Fund shares was a problem and at times lasted for weeks. Tr. 1598, 1601. FAs were quite vocal in their complaints and Del Valle's BOM and sales manager spoke about the issue at sales meetings and explained that when everyone was trying to exit, jams resulted. Tr. 1576-77, 1584-85. Management told FAs there was nothing they could do because the Trading Desk was not buying. Del Valle considered the advice that FAs should seek cross orders from clients to be a bad practice. Tr. 1584-85. Del Valle never saw the Handling and Trading Guidelines that were applicable in situations where the Trading Desk stopped providing firm bids and offers, and he testified that he did not receive comparable information in any other format. Tr. 1578; Div. Ex. 94.

At a sales meeting led by Ortiz and Rosado on February 5, 2009, Del Valle did not hear anything about an FA's obligation to clients in times of illiquidity, and the increased sales volumes indicated to him that the Trading Desk was providing liquidity. Tr. 1579-82; Div. Ex. 150. Del Valle deduced from the increased inventory levels and the failure to execute orders that there were no buyers for Fund shares, including the Trading Desk. Tr. 1584. Between fall 2008 and summer 2009, Del Valle found the Trading Desk willing to sell, but only at its offer, and never willing to buy. Going to the BOM and explaining the customer's situation or giving the BOM a paper ticket could be beneficial, and finding a customer who wanted to buy or a price reduction were other measures to achieve execution. Tr. 1597-98, 1639. In his investigative testimony, Del Valle stated that he did not know of anyone trying to sell Fund shares in 2009. Tr. 1683-84. However, in April 2009, he sold Fund shares several times at prices slightly below what the Trading Desk was quoting. Tr. 1735-36. Del Valle testified that the Funds were sold as safe investments so the drop in prices shown on customer statements caused panic. Tr. 1589-90. However, Del Valle also testified he would never say to a customer that Fund shares were safe investments. Tr. 1754-55.

Del Valle testified that he did not receive written information from UBS PR in 2008 that: the Funds' markets were imbalanced, the Funds had more sellers than buyers, there were a number of requests to increase the limits on the Funds' inventory, there were concerns about Fund product fatigue or stagnation, and the periods of illiquidity were longer than previous experience. Del Valle did not receive written information from UBS PR in 2009, that an inventory increase request was denied for the first time, the Trading Desk was buying minimum shares, the Trading Desk was re-pricing Fund shares to eliminate marketable GTC orders, and the Trading Desk had been directed to reduce Fund inventory from $30 million to $12 million. Tr. 1782-85. Del Valle testified that he did not have this information to disclose to clients, one of whom bought shares in March 2009. Tr. 1783-85.

Del Valle considered it extremely important for FAs to know that UBS PR sought successive inventory increases because many potential buyers looked to the Funds for income through the dividend reinvestment program and this information indicated that they should not buy the Funds because they might not get a monthly dividend check. Tr. 1585-86. To Del Valle, UBS PR's requests indicated that the liquidity issue was not temporary as management represented. Tr. 1586.

Del Valle thought the price of Fund shares was based on supply and demand, but prices did not fall as much as they should have in early 2009 when there was no demand. Tr. 1588-89, 1749, 1772. In January 2009, slides used in a presentation to FAs stated Fund prices had dropped due to supply and demand imbalance. Tr. 1728-29; Ortiz Ex. 282. Del Valle knew that the Funds' prospectuses stated:

> The market price of the Shares will be determined by such factors as relative demand for and supply of such Shares in the market, general economic and market conditions, and other factors beyond the control of the Fund.

Tr. 1693; Ferrer Ex. 515 at 7.

Between February and March 2009, customers complained to FAs about share prices falling 15% to 20%, and at sales meetings BOMs always told FAs that the situation was temporary and they were trying to work things out and provide liquidity. Tr. 1603-04. Del Valle bought shares of the Puerto Rico AAA Portfolio Bond Fund for a client on March 2, 2009. Tr. 1668-69; Ortiz Ex. 396.

In June 2009, Del Valle remembers that Ortiz, Rosado, and Prats explained to FAs that New York was forcing them to reduce inventory, which Del Valle understood to mean that the Trading Desk had less ability to buy shares and less liquidity. Tr. 1731. Del Valle testified that Ortiz said the reduction would be done gradually without lowering Fund prices; however, in his investigative testimony he did not state that Ortiz said prices would not be reduced. Tr. 1609, 1730-34. Ortiz did not tell the FAs not to share this information. Tr. 1606-09; 1729-32. At a sales meeting on July 8, 2009, Highley and an assistant gave a presentation which made the point that the Funds were good investments and did not disclose that the Trading Desk was lowering its offer to levels below pending customer limit orders to sell shares and reduce inventory. Tr. 1604-06; Div. Ex. 76. Del Valle considered this important information for the FAs to have in advising customers. Tr. 1606.

Carmen San Miguel

Carmen San Miguel (San Miguel) worked in sales for 2 major pharmaceutical companies until March 2007, and in June 2007, at age 52, she deposited her retirement and severance totaling $344,000 with UBS PR. Tr. 1788, 1791, 1794. San Miguel explained to her FA, Pedro Martinez (Martinez), that she wanted to invest for earnings, but with low risk because her future employment opportunities were doubtful. Tr. 1791-92. At the recommendation of Martinez, San Miguel invested:

- $45,493 in the Puerto Rico AAA Portfolio Target Fund on June 6, 2007;

- $19,995 in the Puerto Rico Investors Tax Free Fund III on September 14, 2007;
- $20,695 in the Puerto Rico Fixed Income Fund V on April 29, 2008;
- $80,312 in the Puerto Rico Investors Tax Free Fund III on January 28, 2009;
- $29,543 in the Puerto Rico Investors Tax Free Fund II on January 29, 2009;
- $18,478 in the Puerto Rico Fixed Income Fund III on September 29, 2009; and
- $8,403 in the Puerto Rico Investors Bond Fund I on September 30, 2009.

Div. Ex. 107 at Bates 0310, 0403, 1005; Ortiz Ex. 399.

San Miguel had a conversation with Martinez around September 2009, when she was concerned at the reduction in the value of her account. Tr. 1797. Martinez told her the Fund earnings were good and Fund shares were relatively easy to sell. Tr. 1787-99. He did not mention any risks. Tr. 1798. In her investigative testimony, San Miguel acknowledged being shown literature that mentioned risk, but she said that, when an FA talks to you, he takes away all fear. Tr. 1820-21. San Miguel was concerned at the incredible drop in the value of her holdings in 2008, but it appears she was referring to her equity holdings in a UBS PR account, which lost $42,900 in value in 2008. Tr. 1805, 1808; Div. Ex. 107 at Bates 0964.

At the end of 2009, San Miguel closed her equity account and opened an IRA account that held Funds. Tr. 1808. On February 10 and 11, 2009, San Miguel sold shares in five Funds at the bid price shown on the inventory sheets. Tr. 1817-19; Ortiz Ex. 399 at 9-10. On September 3, 2009, she sold shares in one Fund at a loss of $6,834, yet on September 29 and 30, she purchased shares in two other Funds that she does not remember authorizing. Tr. 1823-24; Div. Ex. 107 at Bates 1109. In her conversations with Martinez in August or September 2009, he did not tell her that: (1) Fund prices had dropped in summer of 2009; (2) there were more Fund sellers than buyers; or (3) it was difficult to sell Fund shares. Tr. 1804, 1824-26. San Miguel testified that when she wanted to close her Fund accounts, Martinez warned her of her risks and to be patient. Tr. 1814. In September 2012, her Fund holdings were worth more than her original investment. Tr. 1816-17; Ortiz Ex. 397 at 6. Martinez is still her FA. Tr. 1826.

Osvaldo Torres-Santiago

Osvaldo Torres-Santiago (Torres-Santiago), age 77, is a retired businessman who invested about $50,000 with UBS PR in 2005 when he was looking to earn interest. Tr. 1828-29. His FA, Eduardo Gonzalez, recommended the Puerto Rico Investors Tax Free Fund VI, advising that his money would be safe there and the he would receive a check on the 16th of every month. Tr. 1834. Torres-Santiago did not have the $30,000 annual income shown on his account application dated May 10, 2005, and Eduardo Gonzalez did not give him any literature about the Funds. Tr. 1832, 1840; Div. Ex. 109 at 7. Torres-Santiago did not receive monthly interest as promised. Tr. 1835-37. He constantly had to call Eduardo Gonzalez and request the interest payment, and then go to his office and often wait for hours to pick up the check. Tr. 1835-36.

Also, when his monthly statement showed that his investment had gone down in value to $44,000, Eduardo Gonzalez would show him a screen that showed his investment was valued at $50,000. Tr. 1836-37, 1845. After a few years, Eduardo Gonzalez left UBS PR and his brother Juan Gonzalez became his FA. Tr. 1839. Torres-Santiago believes he first asked to liquidate his investment in 2006. Tr. 1854.

On May 30, 2008, Torres-Santiago's account had a value of $43,611, and on September 30, 2009, it was valued at $36,256. Tr. 1843-44; Div. Ex. 109, at Bates 0153, 0223. Torres-Santiago told Juan Gonzalez many times that he wanted to liquidate his account, because his investment continued to diminish, and Juan Gonzalez would respond that he was fighting for Torres-Santiago. Tr. 1846. Torres-Santiago testified that Juan Gonzalez tried to help him, but told him that things were decided at headquarters by Ferrer. Tr. 1853.

Torres-Santiago went to an attorney who wrote to UBS PR on July 31, 2009, and the attorney called Ferrer's office to complain, but Ferrer was not in. Tr. 1844-48. UBS PR sent Torres-Santiago a check for $17,000 in February 2010, and another $17,000 check in March 2010. Tr. 1848-49.

Hipolito Leon-Nogueras

Hipolito Leon-Nogueras (Leon-Nogueras), age 61, worked as a supervisor in the pharmaceutical industry for over 27 years before retiring in 2007. Tr. 1857. Leon-Nogueras had no prior investment experience and told his FA, Luis Garcia (Garcia), that he wanted a safe investment. Tr. 1858-59. Leon-Nogueras had $414,952 in retirement assets. At Garcia's recommendation, Leon-Nogueras invested about $400,000, in the Puerto Rico Tax Free Fund VI and Tax Free Puerto Rico Fund II on March 20 and July 21, 2008. Tr. 1859; Div. Ex. 101 at Bates 0032. Leon-Nogueras found the advertised safety and almost 7% interest that the Funds paid attractive. Tr. 1860-62. Garcia told Leon-Nogueras that he could withdraw his funds at any time. Tr. 1863-64. Leon-Nogueras's Fund holdings lost $49,500 in value in 2009. Tr. 1869. When Leon-Nogueras voiced concern, Garcia told him that he should not worry because things were going to change. Tr. 1870. Garcia did not tell him that UBS PR was dropping the price of Funds it held in inventory, but there were such reports in the newspaper. Tr. 1869-71.

On June 16, 2009, Leon-Nogueras made a written request to Garcia to consider alternatives because his Fund investments had lost $32,566.20 in value in approximately one year. Tr. 1873; Div. Ex. 100. Garcia told him that withdrawing the funds would be a mistake. Tr. 1874. Leon-Nogueras trusted Garcia, and took no action. Tr. 1873-74. Leon-Nogueras still holds Fund shares, and Garcia is his FA. Tr. 1875-76.

In September 2012, Leon-Nogueras's Fund shares were valued at $349,000. Tr. 1878. His withdrawals have been about $45,000, and he has received about $2,000 a month or about $25,000 a year. Tr. 1877-78; Ortiz Ex. 400.

Roberto Cintron-Estades

On September 5, 2008, Dr. Roberto Cintron-Estades (Cintron-Estades) invested $90,004.70 in the Puerto Rico Fixed Income Fund, which his FA, Manual Melendez (Melendez) told him was a no-risk investment, and that Cintron-Estades would have no problems withdrawing his investment. Tr. 1883, 1886-87; Div. Ex. 103 at Bates 0253. Melendez said that if the Fund went down in value, it would be a small decline and the value would come back up shortly. Tr. 1889. Cintron-Estades reinvested interest. On February 27, 2009, Cintron-Estades' original investment fell to $89,542.60, on March 31, 2009, it fell to $88.446.16, and on June 30, 2009, it was valued at $79,674.64. Tr. 1895-97; Div. Ex. 103 at Bates 0280, 0336, 0347. Cintron-Estades was not able to reach his FA, but he talked to someone else at UBS PR who told him that he should not have invested in the Puerto Rico Fixed Income Fund. Tr. 1898-99.

Cintron-Estades filed a complaint with UBS PR on June 11, 2009, in which he stated that his requests to sell his Fund shares were ignored. Div. Ex. 102. The Fund shares in his account were sold on July 2, 2009, for $83,546.43. Tr. 1905; Div. Exs. 102, 103 at Bates 0297. This amount includes his original investment and reinvested interest.

Sonia Marrero De Diego

Sonia Marrero De Diego (De Diego) has worked as a pharmacist for 45 years. Tr. 1914. De Diego told FA, Jorge Pesquera (Pesquera) that she had $20,000 to invest and that she wanted to divide it between a safe tax-free investment with a good return, and an investment with more risk. Tr. 1916-18. At the FA's recommendation, De Diego invested $10,000 on February 28, 2008, and $5,000 on April 29, 2008, in the Puerto Rico Fixed Income Fund V 2008, and $5,005 on April 23, 2008, in an aggressive fund. Tr. 1922-24; Div. Ex. 105 at Bates 0159, 0184. De Diego had her Fund earnings reinvested in Fund shares. Tr. 1920, 1924, 1938. Pesquera told her that she could sell the investment quickly or immediately and that his relatives had invested in this Fund. Tr. 1919-20, 1928.

On February 27, 2009, De Diego's Fund investments and earnings, with a cost basis of $15,939, were valued at $15,664. Tr. 1924-25; Div. Ex. 105 at Bates 0061. When she told Pesquera in early 2009 that she wanted to sell her shares because they were losing value, he told her their performance would improve and she agreed not to immediately divest. Tr. 1925-26, 1937. At no time did Pesquera tell De Diego that there were more people selling the Funds than there were people buying them, or that UBS PR had been lowering the price of Fund shares. Tr. 1930.

De Diego repeated her request to sell in April or May 2009, and Pesquera agreed to do so, but said it would take time because a lot of people were selling. Tr. 1928-29. On May 29, 2009, De Diego's Puerto Rico Fixed Income Fund V shares, including reinvested earnings, were valued at $15,121.58. Tr. 1937; Div. Ex. 105 at Bates 0026-27. De Diego sold her Fund shares in late May 2009. Div. Ex. 105 at Bates 0017-18. The Fund shares purchased on February 8, 2008, were sold for $758 less than De Diego paid for them and the shares she purchased on April 29, 2008, were sold for approximately $384 less than she paid for them. Tr. 1939-40.

Matilde Lopez-Ramirez

Matilde Lopez-Ramirez (Lopez-Ramirez) is a non-practicing dentist with an elderly mother with Alzheimer's and an ill sister. Lopez-Ramirez invested inherited funds to pay for their custodial care with FA Eduardo Gonzalez and then with FA Juan Gonzalez, at Merrill

Lynch and later at UBS PR. Tr. 1941-44. She told the FAs, who she trusted, many times that she needed very secure investments. Tr. 1943-45, 1948. She wanted to earn more money than a bank offered, but Lopez-Ramirez would not have invested in the Funds if she had known there was a risk she could lose money. Tr. 1949-52. Eduardo Gonzalez assured her that her investment was very secure. Tr. 1952-53. She received monthly interest on her investment of about $2,000. Tr. 1953, 1972.

Lopez-Ramirez followed the advice of her FA in 2003 or 2005 and did not know what Funds her money was invested in. Tr. 1948. Lopez-Ramirez invested in three Funds: the Puerto Rico Investors Tax Free Fund III and IV, and Tax Free Puerto Rico Fund II. Tr. 1972, 1975; Div. Ex. 112 at Bates 0885. Lopez-Ramirez's account had a value of $383,900 in 2005, $350,100 in 2006, $338,900 in 2007, $340,400 in January 2008, $331,622 on February 27, 2009, and $292,852.91 on June 30, 2009. Tr. 1954-55, 1960-61; Div. Ex. 112 at Bates 0885. At one point in 2009, the value of her Fund holdings dropped $12,000 in one month. Tr. 1961 .

Lopez-Ramirez testified that she thought she could withdraw her funds whenever she wanted to, but found out she could not when it was too late. Tr. 1945, 1955-58. Lopez-Ramirez asked to withdraw all her money in 2007, in 2008, and in 2009. Tr. 1955-62. She testified that she did not specify a specific price. Tr. 1968, 1970-71. Her FA, Juan Gonzalez, told her she would have to wait. Tr. 1949, 1995-96, 1961-62, 1967. She needed the funds for a family emergency. Tr. 1954. Between June 7 and September 15, 2009, Lopez-Ramirez sent Juan Gonzalez at least 8 e-mails and 1 certified letter pleading with him to sell her Fund shares. Tr. 1961; Div. Ex. 113. She met with Juan Gonzalez in 2007 and again on May 5, 2009, and renewed her sales request and he told her that the sales had to be done gradually. Tr. 1964-66. Juan Gonzalez never told her that UBS PR was reducing the price of Fund shares, or that UBS had instructed it to reduce its Fund holdings. Tr. 1967. Lopez-Ramirez filed a complaint with UBS on July 9, 2009. Div. Ex. 111 at 267. A UBS PR letter dated November 24, 2009, addressing her complaint states that Lopez-Ramirez shares were sold in September 2009. Tr. 1971; Div. Ex. 111 at 0279. Lopez-Ramirez believes she lost about $100,000 on her Fund investment. Tr. 1971.

Jorges Flores-Alvarez

Jorges Flores-Alvarez (Flores-Alvarez), owner of U.S. Customhouse Brokers and Freight Forwarders, used FA Carlos Pou to invest in the Funds because he was advised they paid higher interest than the banks. Tr. 1980-81. He wanted to increase his capital and did not want the investment to lose anything. Tr. 1981-82. The FA told him that the Funds paid high dividends and that he could get return of his money. Tr. 1982. Flores-Alvarez's account application stated that he was willing to take moderate risk and he wanted no loss on the principal. Tr. 1986-88. Between 2001 and 2005, Flores-Alvarez invested about $2.4 million in the Funds and about $2 million in preferred stock. Tr. 1984. He closed his account in 2004, but returned to UBS PR in 2005. Tr. 1984-85.

In November 2005, Flores-Alvarez was invested in 5 of the Funds with a value of $2,139,955. Tr. 1988, 2002; Div. Ex. 111 at 96. He received interest totaling about $120,000 a year. Tr. 2006-08. Flores-Alvarez deposited $228,000 into the Puerto Rico Fixed Income Fund V in April 2008, through FA Juan Goytia (Goytia), who also told him the Funds paid high dividends and there was no risk that he would lose his principal. Tr. 1989-92. In February 2009, Flores-Alvarez owned 6 of the Funds with a value of $2,251,008 and in September 2009, the value was $1,986,773. Tr. 1998-97; Div. Ex. 110 at 384. Goytia told Flores-Alvarez that the drop in value was temporary and the reason was the world recession. Tr. 1998. Flores-Alvarez asked to sell his Fund investment in late 2009 or early 2010 and the sale occurred in early February 2010, for about $1,994,658. Tr. 1998; Div. Ex. 110 at 486.

Goytia did not tell Flores-Alvarez that UBS PR was reducing the price of the Funds, or that UBS had directed that it reduce inventory. If Flores-Alvarez had known these things, he would have sold his Fund shares earlier because they increased the risk. Tr. 1999.

Federico Hernandez-Pico

Federico Hernandez-Pico (Hernandez-Pico) holds undergraduate and MBA degrees from Columbia University and a Juris Doctor degree from the Inter American University of Puerto Rico. Tr. 2011. While he worked at UBS PR, Hernandez-Pico's 70 to 80 customers had between $60 and $100 million dollars in AUM; from 35% to 50% of those customers were invested in the Funds. Tr. 2012. Hernandez-Pico was an FA with UBS PR from 2005 until 2012. Tr. 2010. He was disciplined in 2010 and terminated in 2012 for allegedly creating false documents and soliciting clients of another FA. Tr. 2056-57. He has a pending FINRA complaint for illegal termination. Tr. 2010.

Hernandez-Pico considered the Funds to be a fixed income product that provided monthly income to investors who were conservative to moderately conservative and their prices were generally stable. Tr. 2013, 2030. He considered the Funds to have low volatility and that investors were not sensitive to price decreases. Tr. 2014. Hernandez-Pico testified he did not know of a relationship between a Fund's inventory and its liquidity. Tr. 2017. He was not aware that in 2008-2009, UBS PR's inventory increased to over $50 million in value, that UBS PR had requested increases in its inventory limits, and that in March 2009, UBS refused to allow the inventory limit to increase to $55 million. Tr. 2025-26. Hernandez-Pico testified that knowing these things would have assisted him in advising his clients. Tr. 2026. Hernandez-Pico testified that he was never told in writing that FAs should inform customers when the Trading Desk was not currently buying or offering shares, and that a market imbalance may make it more difficult to sell shares. Tr. 2029. If Hernandez-Pico had known that UBS was concerned about the premium Fund shares had over NAV, he would have advised clients to move into Funds with higher NAVs. Tr. 2045. In 2009, Hernandez-Pico did not know that the value of client held Fund shares went down by about $250 million in a 90-day period in 2009 because UBS PR lowered the price of Fund shares. He was recommending Fund shares at the time. Tr. 2047.

On cross-examination, Hernandez-Pico acknowledged receiving, but did not recall reading, the May 15, 2006, memo from Belaval and Ortiz to Managers, Trading Desk personnel, Operations personnel, FAs, and CSAs informing them that: (1) increase in sales orders had, at times, resulted in more sellers than buyers and thus limited liquidity; and (2) in periods of illiquidity it was important that the FAs disclose to clients that there may be a delay in executing sales orders. Tr. 2051; Ortiz Ex. 227. He acknowledged attending a presentation by Legal & Compliance on June 19, 2007, that included a checklist of items to be covered with clients, including an extensive discussion of the possibility of illiquidity. Tr. 2054-56; Ortiz Ex. 231. Hernandez-Pico testified that he did not follow the checklist when dealing with clients. Tr. 2056.

On October 3, 2011, the Human Resources Department at UBS PR sent Hernandez-Pico via e-mail an employment verification letter at his request, which confirmed that Hernandez-Pico was an FA with earnings in 2011 of $126,889. Hernandez-Pico, however, typed and apparently submitted a letter on UBS stationery dated October 5, 2011, stating that Hernandez-Pico was a Vice President of Investments with earnings as of October 10, 2011 of $146,705, with an estimated $66,000 bonus. Tr. 2065-70; Ortiz Ex. 407; Ferrer Ex. 657. A similar incident occurred on February 29, 2012, when Hernandez-Pico wrote employment verification letters with inaccurate financial information, and again provided his office number for verification. Tr. 2072-77; Ortiz Ex. 402. Hernandez-Pico testified that the reason the figures were different was because he was traveling to New York and he might need the information there, previously he told UBS PR officials that "the attachment was sent as a test of my personal information in order to view quality." Tr. 2072-80; Ortiz Exs. 402, 406.

Eric Snyder De La Vega

Eric Snyder De La Vega (De La Vega) has been with UBS PR for 33 years. As the Condado BOM, he supervises 6 or 7 FAs.[50] Tr. 2085-86. In 2008-2009, De La Vega had $275 million in AUM and most of his clients held Fund shares. Tr. 2086. De La Vega testified that the main features of the Funds were quality, non-taxable earnings and inheritance exemption, monthly interest, and reinvestment feature. Tr. 2687. In his investigative testimony, De La Vega stated that he did not read the prospectuses because the Funds were similar; a prospectus was automatically sent to a customer who purchased a Fund in an IPO. Tr. 2091-92. De La Vega used the Funds Quarterly Reviews that showed each portfolio's assets as his basis of information when discussing the Funds. Tr. 2133-34; Div. Ex. 26. De La Vega would put his customers' investments into Funds that had the best NAV. Tr. 2112. De La Vega was familiar with the Funds brochure and would give it to secondary market customers who asked for additional information. Tr. 2094. The Funds had an obvious supply and demand imbalance in 2008-2009, which peaked at the end of 2008 and got better or worse depending on the Fund and the time. Tr. 2096-97. De La Vega testified that he disclosed risk to customer, which was mainly liquidity risk in 2006 and then again in 2008-2009; he did not check that FAs discussed risk with their Fund customers. Tr. 2087-89, 2090, 2097-98.

In 2006, customers had a problem getting Fund sell orders executed. Tr. 2099. In 2008-2009, De La Vega spent most of his time talking with customers who wanted to sell. Tr. 2101. He advised customers not to sell their shares; if they insisted, he told them to get in line and think it over but that the smart thing to would be to buy. Most of his customers decided not to sell. Tr. 2100-02, 2107. The 2 or 3 customers who wanted to sell had to wait days or weeks, but it was not too "bad at the end." Tr. 2102-03, 2137. De La Vega believed that Fund price would come back in value. Tr. 2107, 2116. De La Vega reasoned that nothing had happened that changed

[50] De La Vega began in the securities business in 1982 and opened the Condado branch in 2007. It now has seven FAs with about over a billion dollars in AUM. All the FAs are college graduates, some with Masters or law degrees. Tr. 2129-30.

the Funds as a good investment because the underlying securities were the same. The Funds were paying dividends, and while real estate and bank preferred shares were unsellable, customers could still sell their Fund shares. Tr. 2136-37.

In his investigative testimony, De La Vega recalled that Rosado told him that the Trading Desk was not taking any orders at any price level. De La Vega checked on order flow daily. Tr. 2104-06. De La Vega believed some of his customers placed GTC orders. Tr. 2108-09. De La Vega testified that during this period, United States Treasuries fell more than Fund shares, which dropped 20% or 25%. Tr. 2110. De La Vega thought the drop in Fund shares was because there were more sellers than buyers and that people were selling out of fear. Tr. 2107, 2110.

De La Vega thought UBS PR would be shooting itself in the foot if it lowered Fund prices below open customer orders in 2009 to reduce inventory because it would reduce the value of customer holdings and would increase their fears about owning Fund shares. Tr. 2112-14, 2135. The situation was caused by market forces, not the quality of the Funds. Tr. 2114. In prior testimony, De La Vega testified that it would have changed his advice to clients if he had known that UBS PR was selling shares from inventory, but at the hearing he said it would not have changed his advice because he was not advising customers to sell. Tr. 2116-17.

De La Vega testified that by the time of Ferrer's e-mail to Ortiz in January 2009, it was obvious to FAs that there was a supply and demand imbalance in the market for Fund shares, and FAs were complaining about significant drops in Fund prices. Tr. 2137-38. De La Vega questioned Rosado in the summer of 2008 as to why when interest rates were going down, Fund prices did not go up. In a response, Ortiz told him what he always told him, the Trading Desk did not set the prices, it was a matter of supply and demand, and for prices to go up there had to be more buyers. Tr. 2138-39. De La Vega believes that reducing inventory was a bad business decision because inventory was needed to calm people's fears. Tr. 2120. De La Vega knew of Fund buyers in 2008-2009. Tr. 2135. In 2012, shares of all Funds comprised at least 55% of De La Vega's personal portfolio. Tr. 2135-36.

Eladio Perez-llama

In 2008-2009, Eladio Perez-Ilama (Perez-Ilama) had approximately 27 years of industry experience, between 400 and 500 retail customers, and about $150 million AUM. Tr. 2177-79. He charges a 1% commission. Tr. 2207. About 20% of his customers were invested in the Funds. He was paid on a commission basis. Tr. 2179-80. Perez-Llama was familiar with the Fund brochures and prospectuses, but the main thing he used when talking to customers was the latest Quarterly Review that had the breakdown of portfolio assets. Tr. 2181; Ferrer Ex. 639. Perez-Ilama was told that FAs should discuss risk with clients and he did, particularly the risk of using leverage and illiquidity. Tr. 2211. At the hearing, Perez-Llama testified that demand for the Funds decreased for a short period in 2006 and again in the middle of 2008, however, in prior sworn testimony he only remembered a prior demand decrease in 1998. Tr. 2181-82.

In 2008-2009, Perez-Llama could see from the inventory sheets that the Fund prices were falling, and there was an enormous buildup of inventory. Tr. 2204-05. He was aware of an order imbalance and issues with execution of sell orders. Tr. 2184-86. The appearance of 1 for a bid on an inventory sheet signaled illiquidity. Tr. 2181-86, 2201, 2206-07. The BOM, Belaval, Ortiz, Highley, and Rosado made presentations to FAs explaining that the Funds were intended to be long-term investments with tax-free and there were positive advantages to not selling shares. Tr. 2198-99. Perez-Llama advised his clients not to sell their Fund shares, but stopped recommending them for a while. Tr. 2183, 2204. Later, he began recommending them because of their positive qualities. Tr. 2210. Perez-Llama preferred investing in existing Funds, and he agreed with FA Snyder's concerns about the new Puerto Rico Fund VI in 2008 because of the number of Fund shares already in the market. Tr. 2195-96.

Perez-Llama believed that the Funds' illiquidity in 2008-2009 was due to failure of financial institutions, such as Lehman Brothers and Bear Stearns, poor performance by the stock market, and defaults on the preferred stock of local banks. Tr. 2183. He knew when he e-mailed Rosado on December 11, 2008, that the problem was supply and demand. Tr. 2203. His clients were suffering because most of their investments outside the Funds were underperforming as well. In January 2009, Perez-Llama's customers called him about the 5% drop in the value of their Fund shares in November-December 2008. Tr. 2196-97.

Luis R. Fernandez-Diaz

Luis R. Fernandez-Diaz (Fernandez-Diaz) was an FA at the Mayaguez branch from 1997 until February 2011, when he left to join Popular Securities. Tr. 2215. At UBS PR, he had about 400 customers, about half of whom were invested in Funds, and approximately $90 million in AUM. Tr. 2216. Fernandez-Diaz testified that Ortiz and Rosado sometimes participated in weekly sales meetings either in person or through conference calls. Tr. 2217. The main attractions of the Funds were the tax-free monthly interest, the absence of the inheritance tax, the nature of a long-term investment, and diversification. Tr. 2220, 2234. Fernandez-Diaz testified that he explained to his customers the risks that prices might go down and in periods of illiquidity, they might not be able to sell shares as quickly as they would like. Tr.2234-35.

In 2008-2009, supply and demand for the Funds was out of balance, and there were delays in selling shares received in the dividend reinvestment program. Tr. 2222-24. Fernandez-Diaz believed that the Funds were priced using supply and demand, and he testified that UBS PR always tried to keep its customers educated. Tr. 2222-23. He acknowledged that in 2008-2009, UBS PR: (1) wanted its FAs to keep customers calm (2) tried to keep its customers educated; and (3) along with its FAs, did not want Fund customers to sell their shares. Tr. 2224. Fernandez-Diaz submitted limit orders for his customers because market orders could be executed very low, such as 15 cents to 30 cents below the customer's offer to sell or the bid shown on the inventory sheets. Tr. 2225-27. Fernandez-Diaz and some of his customers attended the 2009 Investor Conference where Ortiz made a presentation, but Fernandez-Diaz does not recall what he said. Tr. 2228.

In 2009, Fernandez-Diaz heard informally at sales meetings that UBS PR was significantly reducing its inventory, and he might have heard that it was doing so because of pressure from its Swiss parent. Tr. 2231-32. In 2009, FAs were upset about the drop in Fund prices. The discussion at sales meetings was that the price drops were due to normal economic cycles. Tr. 2231-32. In prior periods of market imbalance, UBS PR had tried to reduce inventory in particular Funds. Tr. 2235-36.

Wilson D. Colberg-Trigo

Wilson D. Colberg-Trigo (Colberg-Trigo) has been in the securities industry since 1983 and became an FA at PaineWebber, now UBS PR, in 1987. Tr. 2238-39. In 2008-2009, he was the top producing FA in the JX Hato Rey branch office with about $700 million in AUM. Tr. 2239. The Funds were 50% or more of the assets held by about 164 of his 700 customers. Tr. 2238-39; Div. Ex. 69. Many of his customers were in the dividend reinvestment program and sold reinvested shares. Tr. 2242. IPO customers receive the prospectus. Colberg-Trigo is not sure whether secondary market purchasers also receive it. Tr. 2243. Colberg-Trigo informs customers of a Fund's yield compared with the yield on other fixed instruments, a Fund's NAV, market value, assets in the portfolio, exemption from inheritance taxes, and tells them it is a long-term investment. Tr. 2243. He believes that the Funds are the safest investment in the world. Colberg-Trigo works with 2 assistants and a clerk so he cannot guarantee what information each customer received Tr. 2244.

Colberg-Trigo does not remember knowing about requests to increase inventory limits between April 2008 and March 2009, or in 2009, that UBS PR was reducing inventory. Tr. 2247-48. He remembers some days when some Funds did not trade, but he was not told in 2009 that the Trading Desk was buying the minimum shares possible. Tr. 2249. He recalls that at certain times it took days or even months for large sell orders to get executed. Tr. 2249.

Colberg-Trigo remembers Price meeting with the top producing FAs in late 2009 and stating that he had made a mistake in reducing the limits on the purchase of Fund shares. Tr. 2250. From this, Colberg-Trigo understood why trades took a while to execute. He and the other FAs were surprised by the actions of UBS towards UBS PR. Tr. 2251-52. Colberg-Trigo did not inform his customers about the inventory reduction. Tr. 2252. Colberg-Trigo is not a net seller. He has been in the market many years and does not concern himself with slow order execution. Tr. 2251.

Respondents' testimony from FAs

Carlos Jose Freire Borges

Carlos Jose Freire Borges (Borges), a graduate of Babson College, has been an FA since March 2007. In 2008-2009, Borges was a member of a 7-person team in the Guaynabo office that had millions under management of which about half was invested in the Funds.[51] Tr. 2773. In 2008-2009, Borges considered the Funds to be the best investment available for his customers because of the yield and strong fundamentals of the investments in the Fund portfolios. Tr. 2773-74, 2808. UBS PR instructed Borges to inform his customer about the risk of Fund ownership, and he did so. Tr. 2777-81, 2801. He used the GTC book to find opportunities for clients. Borges noted that NAVs of the Funds fell in 2008-2009, but he was not concerned. He looked for Funds with lower NAVs because they provided more leverage if a customer sold his reinvested shares. Tr. 2795. Borges testified that, FAs generally understood in 2008 and early 2009, that the Fund markets were not in balance and that liquidity was not as strong as it had

[51] The Guaynabo was one of the largest UBS PR branch offices with 50 FAs. Tr. 2789-99.

been. Tr. 2800. In 2008-2009, Borges testified it took usually from 1 to 3 days for his team's 300 customers to sell shares. Tr. 2796. In 2009, his team eliminated the reinvestment program for clients so they would receive a cash payment. Tr. 2786-97.

Ricardo Eboli

Ricardo Eboli (Eboli) graduated from Brown University and graduated from the University of Puerto Rico Law School in 2008. Tr. 2810. Eboli joined UBS PR as an FA in 2002. Tr. 2810. Eboli handles most of the fixed income trades for a team of FAs that have a little over $2 billion in AUM. Tr. 2811. In 2008-2009, Eboli took advantage of market dislocation for a client(s) by engaging in buy-backs. For example, by selling shares in a perpetual AAA fund, the Puerto Rico AAA Portfolio Bond Fund II, above the market price, and buying a target AAA fund that was selling below par but which expected to return par on the target date, the Puerto Rico AAA Portfolio Target Maturity Fund. The transactions were in the $4 million to $5 million range. Tr. 2816. Eboli testified that paragraph 81 of the OIP appeared to describe this June 22, 2009, transaction, which was done to move a client into a more conservative investment with the same credit quality and cash flows in a time of market uncertainty. Tr. 2816-17. Eboli, denied that this transaction was to assist UBS PR reduce inventory. Tr. 2818-19. In response to whether this transaction was to help UBS, Eboli, who was a credible witness, stated, "UBS is my employer, and this sounds corny, but we work for our clients." Tr. 2819.

Expert Witnesses

<u>Division expert witness</u>

Dr. Edward Shannon O'Neal (O'Neal), a financial economist, testified for the Division as an expert in investment companies, a group that includes closed-end funds.[52] Tr. 2272. O'Neal's assignment was to determine whether statistical evidence supported the allegations in the OIP. Div. Ex. 152 at 2. O'Neal submitted direct, rebuttal, and supplemental written testimony that he affirmed as a witness. Div. Exs. 152 with 6 Exhibits and 2 Appendices, 153 with Exhibit 1, and 156 with 2 attachments, respectively.

Direct testimony

In his direct evidence, O'Neal studied the correlation[53] between share price and NAV (correlation) for sets of similar funds (control groups) with data for each of the 23 Funds for 3

---

[52] O'Neal received a B.S., in electrical engineering, in 1986 from North Carolina State University, an M.B.A. from Auburn University in 1989, and a Ph.D. in finance from the University of Florida in 1993. Div. Ex. 152, App. 1. He has taught at several universities, worked at the Commission for a year, was a principal at an investment advisor from 2000-2007, and has been a principal with Securities Litigation and Consulting Group, Inc., since 2007. <u>Id.</u>

[53] Correlation is a measure of the linear relationship between two variables that ranges from -1 to 1. Div. Ex. 152 at 11. A correlation of 1 indicates that the 2 variables increase or decrease at the same

time periods: (1) October 2005 to April 2008 (Period One); (2) May 2008-February 2009 (Period Two), when the Trading Desk was requesting increases in inventory; and (3) March 2009-September 2009 (Period Three), when UBS PR directed the Trading Desk to decrease Fund inventory to $12 million. Id. at 10. O'Neal concluded that the pricing of UBS PR closed-end Funds was systematically different from what would be expected if supply and demand determined Fund prices. Id. at 5.

As evidence of systematic differences, O'Neal noted that:

1. Similar closed-end funds typically traded at a discount to NAV, while the Funds traded at a premium in all three time periods, and the premiums increased after May 2008.[54] Div. Ex. 152 at 2. Between May 2008 and September 2009, the control groups traded at an average discount of between 3% and 6%, while the Funds traded at an 18% premium. Div. Ex. 152 at 30.

2. The Funds' average correlation between price and NAV was similar to the correlation between price and NAV of the control group from October 2005 to April 2008, but the Funds' correlation between price and NAV "broke down" from May 2008 onward, and in the time period March 2009-September 2009, the correlation for the control group remained high but that correlation for the Funds became negative. Id. at 8, 13-17. Specifically, the average correlation in the three periods is shown in the following table:

	Period One (Oct. 2005-Apr. 2008)	Period Two (May 2008-Feb. 2009)	Period Three (Mar.-Sept. 2009)
Control Group	0.76	0.97	0.94
Alternative Control Group	0.69	0.96	0.90
Funds	0.83	0.38	-0.34

Id. at 13, Table 3.

O'Neal found that both control groups sold at a discount in all three periods, but the Funds' average premium was 10% in Period One, 18.1% in Period Two; and 17.8% in Period Three.[55] Id. at 10-14. O'Neal cites Ortiz's testimony that the Trading Desk's price

time and in similar proportion or magnitude. Id. A correlation of 0 indicates that changes in the 2 variables are completely unrelated to one another. A correlation of -1 indicates that where 1 variable increases, the other decreases in the same magnitude. Id.

[54] O'Neal used two control groups. One had all closed-end funds that held U.S.-issued fixed income securities with total assets and inception dates similar to the Funds, and the second consisted of 58 exchange-traded closed-end funds with assets from $21 million to $885 million and inception dates from 1993 to 2007. Div. Ex. 152 at 10-11.

[55] A minority of Funds behaved like the funds in the control group. Div. Ex. 152 at 17.

determinations were not related to NAV, and to investigative testimony of Rosado that in 2008 and part of 2009, Fund pricing was more closely linked to yield and the GTC book than to NAV. Id. at 14, 17. O'Neal concludes:

> The low correlations and the premia to NAV exhibited by the UBS PR funds from May 2008 through September 2009 demonstrate that the pricing of the funds was systematically different from what would be expected if investor supply and demand had determined fund prices over this period.

Id. at 17.

O'Neal makes the point that the low correlations and the premium to NAV show that Fund pricing was systematically different from what would be expected if supply and demand had determined Fund prices. Id. at 31. Also, the increasing premiums were primarily the result of decreasing NAVs coupled with artificially stable prices that masked the volatility of Fund assets. Id. at 31. O'Neal acknowledges that a closed-end Fund investor takes the risk that changes in market sentiment will cause fluctuations in Fund prices. Id. at 6.

3. O'Neal found that the Funds experienced rising inventory levels beginning in May 2008 and continuing until March 2009, and he comments:

> UBS PR was buying the excess demand into inventory at the given fund prices instead of allowing prices to adjust downward. The rising inventory allowed UBS PR to shield investors from price fluctuations and illiquidity at the prices that were supported by UBS PR. These actions are consistent with the aberrant pricing behavior I find for the funds, especially the low correlations between NAV and fund prices.

Id. at 18.

O'Neal found that during 2008-2009, Fund prices remained relatively constant while the NAV of many Funds decreased, and that the premium to NAV increased as inventory increased. Id. at 52 at 18-19. According to O'Neal, total Fund inventory went from about $32 million on May 5, 2008, to close to $50 million around March 5, 2009, and dropped to about $12 million on September 5, 2009. Id. at 21. O'Neal points to Rosado's testimony that sometimes reducing prices does not bring about a supply and demand balance "especially in 2008 when there was a global financial crisis, and it actually can increase the sell side, create panic, and then get the inventory situation worse." Id. at 18.

4. The large percentage of expired limit orders to sell and other related evidence suggest that UBS PR was lowering Fund prices below the prices of customer sell orders from March to September 2009. Id. at 3. O'Neal determined that on March 19, 2009, Ortiz was told to reduce inventory to $30 million and on May 29, 2009, UBS PR was instructed to reduce inventory to $12 million. Id. at 21. To accomplish the reductions, UBS PR frequently lowered Fund prices customers' pending sell orders in the GTC book and arranged for customers to sell out of new Funds and buy into older

Funds. Id. at 21-22. Specifically, O'Neal testified that UBS PR lowered the price on 15 Funds to reduce the marketable orders in the GTC book. Id. at 22. O'Neal cites one example. On March 3, 2009, the Puerto Rico Investors Tax Free Fund VI had a closing price of $9.65 and approximately $1 million in marketable sell orders. The minimum execution price on the $1 million sell orders was $9.55. On March 4, 2009, UBS PR reduced the price of the Fund shares to $9.54, which removed nearly $1 million in marketable orders from the GTC book.

O'Neal found that between March and September 2009, the share price of 22 of the 23 Funds decreased. Id. Nine were double digit decreases, and 13 of the decreases were in the single digits. Id. at 22-23. Unexecuted orders, a total of expired, rejected, and canceled orders, rose from about 6% in January 2008 to over 99.9% in March 2009. Id. at 24. O'Neal cites Rosado's testimony that he had to comply with the inventory reduction, he had to price shares lower than the GTC book to "comply with the manual." Id. at 27.

5. O'Neal found evidence of irregular trading practices. Id. at 3. O'Neal's review shows evidence that UBS PR switched customers from newer Funds with low inventories to older Funds with higher inventories. Id. at 27. O'Neal testified he found numerous examples and cited an instance on June 22, 2009, when 23 customers collectively sold over 485,000 shares of the Puerto Rico AAA Portfolio Bond Fund and used the proceeds to buy shares of the Puerto Rico AAA Portfolio Target Maturity Fund (PRAAATMF). Id. The drop in the inventory level of the PRAAATMF was the exact number of shares that the 23 customers purchased. Id. A second example on June 26, 2009, involved the selling by 17 customers, collectively, of over 200,000 shares of the Puerto Rico Fixed Income Fund VI and used the proceeds to buy the Puerto Rico Fixed Income Fund II. Id. at 28.

O'Neal testified that UBS PR's inventory reduction and trading and pricing practices harmed investors. Id. at 3. He calculated that Fund shareholders suffered losses of approximately $604.8 million from March 1 to September 30, 2009, based on the decline in Fund prices when shareholders were precluded from selling shares in a timely fashion. Id. at 29. The calculation is the difference between the value of Fund shares on March 1 and September 30, 2009. Id.. O'Neal also calculated the losses suffered by investors due to allowing pending sell orders to expire unexecuted as approximately $16.6 million. Id. at 30.

Rebuttal testimony

O'Neal argues that Respondents' expert witness, Dr. Erik R. Sirri (Sirri): (1) presents a biased view on closed-end fund premia by cherry picking the funds he used to support his position; (2) falsely claims that inventory sales following bid price reductions were not significant; (3) presents a skewed view of the relationship between inventory reductions and customer sales; (4) finds that increasing indicative bids is consistent with UBS PR's withdrawal of support for the market; (5) does not support its claim that customer limit orders were placed at a price far from the existing bid price; (6) claims Fund shareholders did not react to high prices by attempting to sell their shares, but looked only at sales and did not consider increased sell orders; and (7) does not show that Fund inventory increased. Div. Ex. 153 at 2-17.

O'Neal states that Sirri does not contest his conclusion that Fund pricing was systematically different from pricing by other closed-end Funds from May 2008 to September 2009. Id. at 5. O'Neal repeated his correlation analysis over the three periods, including 17 funds chosen for analysis by Sirri and claims the results are qualitatively similar to his direct testimony.

	Period One (Oct. 2005-Apr. 2008)	Period Two (May 2008-Feb. 2009)	Period Three (Mar.-Sept. 2009)
Universe of fixed-income Closed-end funds	0.83	0.96	0.97
Sirri's 17 funds	0.71	0.92	0.91
Funds	0.83	0.38	-0.34

Id. at 6.

O'Neal calculated that the Funds experienced net customer sales of 7,147,788 shares between March 2 and September 30, 2009, which represented 33% of the shares sold during the period. Id. at 9. UBS PR was the dominant net seller during the period between March 2 and September 30, 2009, even though its inventory was approximately 1% of Fund shares outstanding on March 2, 2009. Id. at 10. O'Neal disputed Sirri's position that UBS PR's indicative bids were not misleading. Id. O'Neal found a statistically significant increase in the volume of monthly sell orders from the period June 2006 to May 2008, to the period covered by the OIP, May 2008 to September 2009. Id. at 15.

Supplemental testimony

O'Neal re-analyzed his correlation testimony to consider Sirri's criticisms with the following results:

	Period One (Oct. 2005-Apr. 2008)	Period Two (May 2008-Feb. 2009)	Period Three (Mar.-Sept. 2009)
Control Group	0.73	0.94	0.90
Alternative Control Group	0.67	0.95	0.88
Funds	0.41	0.36	-0.31

Div. Ex. 156 at 5.

O'Neal's modified position is that (1) most closed-end funds trade at a discount to NAV, but the Funds consistently traded at a premium to NAV in all time periods; (2) the Funds' premia increased from May 2008 onward; (3) the Funds' NAV was negative from March to September 2009, the same period when UBS PR reduced inventory; (4) in no period did the Funds have an average correlation that was similar to a control group's correlation; and (5) the Funds' correlation moved in a different direction than the control groups' correlation between Period One and Period Two, and the Funds' correlation became negative from March 2009 onward. Id. at 6. O'Neal found that the Funds' prices stayed constant for extended periods,56 are less variable that the prices of other closed-end funds, and that amount of unexecuted sell orders was high in March 2009, a corrected 82%. Id. at 17,-18, 20, 22; see also Div. Ex. 132 at 24. O'Neal found it unusual for the Funds to trade consistently at premiums over NAV, and he had never before seen a negative correlation between price and NAV. Tr. 2423-24.

Respondents' expert witness

Sirri presented direct testimony consisting of a written statement with Appendices A-C, and Exhibits 1-18.[57] Ortiz Ex. 201. Sirri's rebuttal expert testimony consists of a written statement with and Appendices A-D, and Exhibits 19-30. Ortiz Ex. 202.

Direct testimony

Sirri concluded:

1. The fact that the Funds were priced at premiums over NAV does not, itself, show that the Funds were mispriced;

2. Transaction data for the period May 1, 2008, to March 1, 2009, does not support the Division's assertion that Funds were mispriced;

3. Even though total Fund inventories increased during the period May 1, 2008, to March 1, 2009, substantial buys occurred in most of the Funds;

4. The Division criticizes UBS PR for not using a set pricing formula, however, liquidity providers in OTC markets generally exercise discretion about pricing levels;

5. It was reasonable for UBS PR in pricing the Funds to look to other securities trading in relevant financial markets;

6. Indicative bids can be used to convey more accurate information to the market place than very low firm bids, or no bids;

[56] Each Fund had a minimum of 44 days where the price was unchanged and one Fund had a constant price for 224 calendar days. Div. Ex. 156 at 20.

[57] Sirri holds a B.S. degree from the California Institute of Technology, and M.B.A. and Ph.D. degrees from the University of California, Irvine and Los Angeles, respectively. Sirri is currently a professor at Babson College. Sirri was the Commission's Chief Economist, 1996-1999, and Director of Trading and Markets, 2006-2009. He has written many published works and testified in many litigated proceedings. Ortiz Ex. 201 at 1-2, Appendix A, B.

7. Once UBS made a corporate decision to reduce Fund inventories, it was appropriate (indeed necessary) for UBS PR to execute its orders below the price of its lowest customer order;

8. Market participants as a rule do not disclose planned changes in inventory; and

9. Ferrer's comments on the Funds' performance, stability, and liquidity are consistent with the data.

Ortiz Ex. 201 at 3-6, 17.

In support of his conclusions, Sirri notes that academics are still puzzled about the pricing of closed-end funds, but they have identified some factors that they believe affect such pricing, including tax treatment. Id. at 15-16. Sirri argues that while substantial premiums to NAV are not the norm for closed-end funds, they do exist. Id. at 16. Also, certain Funds traded at a premium before, during, and after the relevant period. Id. Sirri opined that the mere fact that the Funds generally traded over NAV does not support O'Neal's opinion that the Funds were mispriced. Id. at 17.

Sirri performed two statistical analyses to test the allegation that Fund prices were too high from May 1, 2008, to March 1, 2009. He found that the majority of Funds did not experience a statistically significant decline in buy volume or a statistically significant increase in sell volume January 1, 2005, to April 30, 2008, as compared with May 1, 2008, to March 1, 2009. Id. at 18-20, Exhibit 5. Sirri argues that if the Funds were mispriced as has been alleged, it would have been shown in investor behavior, and it was not. Ortiz Ex. 201 at 20. In a second analysis, Sirri determined that accounts that had purchased or sold at least 1 million dollars of Fund shares in a single day between January 2005 and March 2012 (sophisticated investors), did not behave as if they believed any of the Funds were mispriced. Id. at 18-20, Ex. 6.

Sirri disagrees with the Division's position set out in the OIP that periodic supply and demand imbalances indicate that the Fund prices were too high from May 1, 2008 to March 1, 2009. OIP at 6; Ortiz Ex. 201 at 21. According to Sirri, in a relatively illiquid market there can be fewer buyers than sellers for reasons unrelated to a Fund's intrinsic value. Id. at 21. Sirri sees UBS PR's legitimate role as a dealer to provide liquidity so that temporary imbalances do not lead to price volatility that is unrelated to the value of the underlying securities. Id. Sirri did an analysis of 14 Funds, and in 12 of them, UBS PR's buys were only 25% of total buy volume. between May 1, 2008 to March 1, 2009. Id. at 21-22. Sirri believes this finding supports his position that, even though total Fund inventory increased, the majority of the Funds had substantial customer buys during this period. Id. at 22, Ex. 7.

Sirri maintains that formulaic or algorithmic methods are used to establish share price quotations only in specialized circumstances. Id. at Ex. 11. He finds it reasonable for UBS PR to have considered the prices of other securities that trade in relevant financial markets when pricing Fund shares. Id. at 27.

Sirri disputes the allegation that the use of indicative bids was misleading with a finding that in the period May 1, 2008, to March 1, 2009, buys were executed at 90% of the quoted bid, regardless of whether the bid was indicative or firm. Id. at 29, Ex. 12.

Sirri points out that when UBS PR sold shares from inventory at prices below pending customer sell orders, it accepted prices lower than what those customers were willing to sell for at the time, and it benefited incoming buy orders that were executed at prices lower than they otherwise would be. Ortiz Ex. 201 at 31. Also, Sirri disputes the Division position that UBS PR crowded out other sellers by its inventory reduction from March 2009 to October 2009. Sirri asserts that UBS PR's inventory reduction was only 20% of total customer sell volume. Id. at 31, Ex. 13.

Sirri asserts that, in general, information about a participant's inventory position is carefully guarded by market professionals. Id. at 33. Sirri challenges the Division's assertion that as of September 30, 2009, UBS PR had $72 million of sell orders in its GTC book. Sirri's analysis shows that less than $350,000 of those sell orders were executable. Id. at 35, note 66, Ex. 15.

Finally, Sirri, disputes the Division's allegations that Ferrer made misleading statements about the Funds. According to Sirri's analysis, Ferrer's comments about Fund returns, low volatility, and liquidity are supported by the data. Id. at 36-38, Exs. 17-18.

Rebuttal testimony

Sirri's rebuttal makes the following points:

1. Certain of O'Neal's analyses contained errors, which O'Neal contended he corrected in his rebuttal;

2. O'Neal's contention that the existence of a premium to NAV, by itself, renders the Funds' pricing process unusual or irregular has no basis;

3. The Funds have several characteristics that may have led them to trade at a higher premium than other comparable funds;

4. O'Neal's control group is not a valid comparison group for the Funds;

5. Even ignoring the deficiencies in O'Neal's control group, his analysis does not support his conclusions;

6. Analysis of customer orders does not imply that UBS PR's trading practices were inappropriate; and O'Neal's estimates of investor losses are speculative, conceptually flawed, and unsupportable.

Ortiz Ex. 202 at 3-8.

Sirri reiterates the points he made on direct. He notes that that some of the Funds in O'Neal's control group traded at a premium to NAV. Id. at 12. Sirri enumerates several characteristics of the Funds that are consistent with trading at a premium: tax advantages; ability to leverage up to 50%; and holding securities offered through private placements, which are not available to retail investors. Id. at 14-19. Sirri has many criticisms of O'Neal's control group, and argues that O'Neal's analyses do not support his conclusion that Fund pricing was atypical. Id. at 19-31.

Sirri concludes that O'Neal provides no support for the implication that the Funds' trading practices were inappropriate, and Sirri found no support in customer orders for the assertion. Id. at 32. Sirri's data analysis of the information O'Neal relied on does not support the claim of improper Fund switching to reduce inventory. Id. at 33-37. Sirri characterizes O'Neal's method for estimating the amount of unexecuted GTC book orders as seriously flawed due to its extremely simplistic nature, mainly because O'Neal relied on day orders. Id. at 37-39.

Sirri criticizes O'Neal's estimate of $604.8 million in investor losses because (1) he could not replicate it; and (2) it implicitly assumes without support that all investors wanted to sell their holdings on March 1, 2009, and were precluded from doing so until September 30, 2009. Id. at 40-41. Sirri argues that the fact that the O'Neal's loss estimates are so different, when both are predicated on investors' inability to sell, underscores their unreliability.

Sirri criticizes O'Neal's estimate of $16.6 million in investor losses because: (1) it makes some unsupported assumptions, including that UBS PR is responsible for the losses; (2) it does not distinguish between marketable and unmarketable orders; (3) appears to include duplicate orders; (4) the results could not be replicated. Id. at 41-44.

Arguments of the Parties

Division

The Division contends that Ferrer made material misrepresentations and omissions in April 2009 during an *El Vocero* interview and in numerous e-mails and memorandums to FAs throughout 2008 and 2009. Div. Br. at 135-41; Reply Br. at 30-41. The Division argues that Ferrer's statements to the newspaper painted a false picture of the Funds' profitability, security, and stability at a time when he knew the liquidity of the Funds' secondary market was decreasing, an order to decrease inventory was given by UBS, and prices were being reduced to allow UBS PR to sell ahead of customers' open orders. Div. Br. at 135-36. The Division also argues that Ferrer's statements and omissions in e-mails and memorandums sent to FAs "painted a rosy picture of the Funds' security, price stability, consistent yields, and profitability without disclosing numerous material facts about, among other things, how UBS PR priced the Funds, the growing illiquidity in the secondary market, and the fact that UBS PR was dropping prices below open customer sell orders to achieve a mandated inventory reduction." Id. at 137.

The Division maintains that Ortiz knowingly made material misrepresentations and omissions directly to customers at a March 31, 2009, Investor Conference and to FAs at a January 21, 2009, presentation. Id. at 127, 129-33, 152-54; Reply Br. at 41-50. The Division contends that Ortiz portrayed the Funds as liquid trading investments by showing increasing trading volumes and prices from 2006 through 2008, and highlighted a "consistent level of closed-end fund trading activity in 2008," when in reality, the Funds had been experiencing a long and difficult period of market imbalance. Div. Br. at 129-30. The Division argues that during the 2009 Investor Conference, Ortiz highlighted and discussed trading volume and liquidity in the Funds' market without disclosing material facts, including the market imbalance, the requests for temporary inventory limit increases, and the investors' difficulty selling their dividend reinvestment shares. Reply Br. at 42-43. Additionally, the Division asserts that in a January 21, 2009, presentation, Ortiz failed to disclose an accurate picture of the existing market conditions because he discussed how the Funds outperformed most asset classes on a total return basis, favorable Fund yields, and why the Trading Desk believed the outlook for Fund prices and yields were strong; however, Ortiz failed to disclose that Fund sellers outnumbered buyers since May 2008, the Trading Desk consistently requested inventory increases to maintain liquidity, and continuing problems with selling dividend reinvestment shares. Div. Br. at 152; Reply Br. at 49. The Division argues that Ortiz's claim that UBS's Legal Department fully vetted Ortiz's Investor Conference presentation should be disregarded as the issue was fully argued and ruled upon during the hearing. Reply Br. at 45.

The Division argues that Ortiz's statements were made in connection with the purchase or sale of securities because he "was discussing the buying and selling of Fund shares in the secondary trading market – i.e., the trading process." Div. Br. at 133-35, 154. The Division argues that Ferrer's statements in the newspaper and in e-mails and memorandums to FAs were made in connection with the purchase or sale of securities because he is not required to recommend a specific Fund for a specific reason or discuss a specific transaction to satisfy the "in connection with" requirement. Id. at 137, 149-50. The Division, relying on Commission and district court cases, states that regardless of the fact that Ferrer's statements were not made directly to customers, he knew, or was reckless in not knowing, that his misrepresentations and omissions to FAs could reach customers, and, in fact, he "urged FAs to communicate his thoughts to customers," and he sent e-mails and memorandums to FAs intending that the FAs try to induce customers to purchase or not to sell their Fund holdings. Id. at 141-45.

The Division also argues that Ortiz and Ferrer acted with the requisite level of scienter. Specifically, the Division argues that the evidence clearly establishes that Ferrer acted with scienter, or at a minimum was severely reckless, in omitting material information. Id. at 136-37. Among other things, the Division argues that Ferrer knew about the weak secondary market and he expressed a desire to fix it; he knew FAs were complaining about the illiquidity and were accusing the Trading Desk of manipulating prices; and he knew the Funds were priced by the Trading Desk to achieve consistent yields and price stability in contrast to UBS PR's public statements. Id. at 136-37, 140-41. The Division argues that the testimony of UBS PR's FAs supports its position that the information conveyed by Ferrer in the e-mails and memorandums, as well as the information which he omitted, was material. Id. at 145-49; Reply Br. at 32. The Division argues that Ortiz acted with scienter because he was clearly aware of the true state of liquidity and pricing in the Funds' secondary market when he made his material misstatements and omissions. Reply Br. at 132-33, 154.

The Division argues further that the "inventory dump" ordered by UBS does not exonerate Ferrer and Ortiz from liability because there is no "good soldier defense" to federal securities fraud violations, and that Ortiz cannot escape liability by arguing that UBS executives approved the price reduction plan. Id. at 13-14. The Division maintains that the claim that FAs knew the Trading Desk was lowering prices below marketable orders in the GTC book to accomplish the inventory dump is incredible, and that Ferrer inaccurately characterizes his e-mails and memorandums to FAs as vague, optimistic statements. Id. at 17-30.

The Division argues that Janus Capital Group, Inc. v. First Derivative Traders, 131 S.Ct. 2296 (2011), is not relevant to this proceeding because there is no issue as to who made the false and misleading statements alleged. Div. Br. at 150. The Division argues it is seeking to hold Respondents liable for the statements they made, not the statements made by the FAs to customers. Id. Also, the Division argues that Janus's requirements for making a false statement only apply to affirmative misstatements under Rule 10b-5(b), but they do not foreclose a finding of liability under Section 17(a) of the Securities Act or Rule 10b-5(b) of the Exchange Act based on material omissions, or scheme liability in violation of Rule 10b-5(a) and (c) of the Exchange Act. Id. at 150-51.

The Division argues that Respondents' reliance on the "Bespeaks Caution" Doctrine (Doctrine) and their argument that the disclosures in the Funds' brochures and prospectuses render their allegedly false statements and omissions immaterial is wrong. Id. at 155-57. The Division argues that the Doctrine is inapplicable because many customers did not receive a brochure or prospectus when purchasing the Funds; therefore, UBS PR did not make the disclosures Respondents claim were made to most customers. Id. at 155. The Division also argues that the allegedly cautionary language in the brochures and prospectuses does not insulate Respondents from liability because they failed to disclose that: (1) the risk that UBS PR would no longer make a market in the shares had become a reality, i.e., UBS PR had essentially stopped maintaining a market in the Funds by the end of March 2009; (2) UBS PR was undercutting customer sell orders in order to sell its own shares; and (3) UBS PR was buying the minimum amount of shares possible in 2009. Id. at 155-57.

The Division contends that UBS PR violated the federal securities laws by making various misrepresentations and omissions and by engaging in a fraudulent course of conduct and scheme and that Ferrer and Ortiz aided and abetted these violations. Id. at 127-28. Specifically, the Division contends that UBS PR misrepresented that market forces such as supply and demand determined Fund prices to customers and FAs in various documents, including the September 2008 Fixed Income Fund VI prospectus and the 2008 and 2009 Family of Funds Brochures, and Respondents aided and abetted those misrepresentations. Id. at 128. The Division argues that UBS PR made misrepresentations and omissions when it: (1) stated in the 2009 Family of Funds Brochure that it maintained and intended to maintain a market but could stop at any time, when in fact it had already stopped; (2) published a list of Fund prices in *El Vocero* and failed to disclose that the prices included sales commissions, the prices were merely indications of value, and the prices differed from what the Trading Desk was offering; and (3) transmitted prices to UBS to include as actual market values in customer account statements, when in fact they were often indicative bids; and (4) that Ferrer and Ortiz aided and abetted these misrepresentations and omissions. Id.

Finally, the Division argues that UBS PR, Ferrer, and Ortiz engaged in a fraudulent course of conduct and scheme in 2008 and 2009 and misled customers and FAs, when they touted Funds as profitable, safe, and stable investments, and represented that supply and demand were responsible for Fund prices. Id. The Division contends this course of conduct, meant to keep prices and yields consistent, masked the illiquidity of the Funds' secondary market. Id. Finally, the Division argues that UBS PR and Respondents engaged in a fraudulent course of conduct and scheme in 2009 and violated their fiduciary duties to customers when they lowered Fund inventory prices below open customer orders in an effort to sell UBS PR inventory first. Id.

Ferrer

Ferrer argues that he did not make any material misstatements or omissions in statements he made to *El Vocero*, and his statements were general statements about the local mutual fund industry in Puerto Rico, not about the Funds as the Division alleges. Ferrer Br. at 2-3, 144-46.

Ferrer argues that his statements to FAs were not false and did not omit material information necessary to make the statements not misleading. Id. at 4. Ferrer argues that his e-mails to FAs contained general statements about the Funds for which he had a sound basis and that witness testimony and documentation supports his opinions. Id. Ferrer contends that the statements in his e-mails, including, among others, that the Funds displayed "superior performance," "low volatility," and were "weathering the 'Wall St. Storm' in a pretty good fashion," were fully supported by contemporaneous performance data and market conditions that were readily available to everyone at UBS PR. Id. at 4-7, 66-73, 86-92. In the alternative, Ferrer argues that even if the statements in his e-mails were taken as more than opinions about Fund attributes, the evidence supports their accuracy. Id. at 7.

Ferrer also argues that he did not omit material information relating to the illiquidity, imbalance, and inventory reduction in the Funds during 2008 and 2009. Id. at 7-15. Ferrer states that the Division, in fact, points out that the FAs were well aware of liquidity problems and frequently complained about them to Ferrer. Id. at 8-9, 61-63, 129-30. Additionally, Ferrer relies on the testimony of numerous FAs, including those called by the Division, as well as contemporaneous e-mails and documents sent to FAs, as support for his argument that the illiquidity and imbalance were well known by the FAs. Id. at 9-13, 62-63, 108-111. Ferrer argues that FAs also knew, among other things, that investment in the Funds was not guaranteed, that the Funds were not listed on any exchanges, that the Funds were only available to residents of Puerto Rico, that the Funds were marketed as a long-term investment, and that the Trading Desk provided indicative bids. Id. at 112-16. Ferrer contends that UBS PR FAs were trained to provide adequate disclosures to customers, and moreover, he was not responsible for such disclosures. Id. at 117-24.

Ferrer argues that he did not violate the federal securities laws by "promoting the virtues of the Funds' without disclosing prices had declined during the mandated inventory reduction." Id. at 13 (quoting Div. Br. at 6). Ferrer asserts that once he learned of the inventory reduction mandated by UBS executives in May 2009, not March 2009 as suggested by the Division, he objected to the decision and did not promote the virtues of the Funds. Id. at 13-14, 53-55, 58-60. He argues that the information contained in the e-mails he sent after May 2009 fairly characterized market information, including dividends and yields. Id. at 14-15. Additionally, Ferrer argues that FAs knew that UBS PR was reducing inventory and lowering prices, and that he was not responsible for disclosing inventory reductions. Id. at 60-61, 137-40.

Finally, Ferrer argues that he cannot be held liable for violating the federal securities laws because the alleged misstatements and omissions were not material, he did not act with scienter or negligently, his statements were not made in connection with the purchase or sale of a security or in the offer or sale of a security, and the Division failed to prove that the FAs repeated any of his statements to their customers. Id. at 149-51. Ferrer also argues that the Division failed to prove that he is liable for scheme liability or that he aided and abetted any violations of the relevant securities laws. Id. at 152-53, 214-222.

Ortiz

Ortiz argues that he cannot be held liable for the alleged violations of the federal securities laws because he did not make material misstatements or omissions, he did not act with scienter, and his statements were not "in connection with the purchase or sale of a security." Ortiz Br. at 271-80.

Ortiz argues that he "acted reasonably, fairly and honestly" and that his actions were "transparent to his supervisors, clear to his subordinates, consistent with UBS's public disclosures and in accordance with UBS policies." Id. at 1. Ortiz argues that the Division mischaracterizes what UBS PR said and what the Trading Desk did. Id. at 2, 122.

Ortiz argues that UBS PR's disclosures identified supply and demand as one factor used in pricing the Funds but that the disclosures also identified other market factors, including comparative yields, that were used in setting Fund prices. Id. at 2, 122, 128. Ortiz argues that UBS PR's consideration of multiple factors rather than only immediate order flow in pricing the Funds is not abnormal and Ortiz relies on Dr. Sirri's explanation that this is how liquidity providers typically operate. Id. at 2. Ortiz maintains that Fund brochures and the prospectuses made clear to FAs and investors that Fund prices were influenced by a number of factors, including supply and demand and yields on comparable instruments; they did not promise that supply and demand would be the sole, predominant, or decisive factor in setting Fund prices. Id. at 123-25.

Ortiz disputes the Division's allegation that the Trading Desk priced the Funds to achieve "price stability." Id. at 129. He argues that the Trading Desk's use of inventory to temporarily bridge gaps in supply and demand was routine and appropriate. Id. at 3, 130-31. Ortiz relies on Dr. Sirri's explanation that the job of a liquidity provider is to "step in when necessary to provide liquidity for investors so that liquidity shocks resulting in temporary imbalances do not lead to pricing volatility that is unrelated to the value" of traded securities. Id. at 3-4, 130. Ortiz asserts that the Division's argument that Fund prices did not reflect supply and demand depends on the simplistic presumption that Fund prices should have mirrored and moved with each Fund's NAV. Id. at 4. He argues that price stability was an objective, secondary to market liquidity, of the Trading Desk's market making activities and that UBS PR's disclosures clearly stated that Fund shares could trade either at a premium or discount to NAV. Id. at 4, 130. Additionally, Ortiz argues that he was not responsible for pricing disclosures. Id. at 131-32.

Ortiz disputes the Division's theory that the fluctuations in the relationship between a Fund's price and its NAV shows that the Fund's price does not reflect supply and demand or a true market. Id. at 154. Ortiz argues that NAV is not a measure of how much supply and demand, or what price, the market will bear; it is a measure of the value of the assets held by the Fund, which is why UBS PR disclosed to customers that the Fund's price was based on several market factors, including supply and demand and the yield on other securities. Id. Ortiz points to the steps taken and conclusions reached by two executives at UBS and the UBS Executive Committee pricing review to support his argument that the Funds' premiums to NAV were appropriate given the market conditions. Id. at 155-61.

Ortiz argues that there was not a constant period of market imbalance between May 2008 and March 2009 as the Division appears to allege; rather, there were instances when supply exceeded demand and other instances during this time when the opposite was true. Id. at 5, 144-45. Ortiz argues that neither he nor the Trading Desk hid periods of market imbalance from FAs. Id. at 5, 139, 145-46. Ortiz points to several e-mails, presentations, and talking points that he shared with FAs indicating that the Funds were experiencing a supply and demand imbalance and that price adjustments were necessary. Id. at 5-6.

Ortiz contends that the Division's allegations are based on claims he was not sufficiently forthcoming about the market conditions for the Funds at a January 2009 meeting with FAs and at the Investor Conference in March 2009. Id. at 6, 139-42, 147-52. Ortiz argues that he made disclosures, where required, regarding the market imbalance and liquidity challenges and asserts that he explained these to be present concerns. Id. at 6, 139, 145-46, 148-52. Ortiz argues that his January 2009 presentation to FAs noted that the decline in Fund prices was "due to a supply and demand imbalance" and set forth causes of the imbalance, including a recession in Puerto Rico and local deals that attracted investors. Id. at 143. Ortiz also argues that the Division is precluded from seeking sanctions with respect to the January 2009 meeting because the Division did not raise issues relating to that meeting until its post-hearing brief. Id. at 139.

Ortiz contends that he did not engage in deceptive conduct relating to the quality of disclosures made in customer account statements produced by the UBS Pricing Department or relating to the transmission of information published in *El Vocero*. Id. at 163-72. He also argues that he did not deceive FAs when he transmitted inventory sheets to the FAs in September and October 2008 that did not disclose the total shares in the inventory of each Fund. Id. at 172. Ortiz asserts that he acted reasonably in relying on the advice he received from within UBS and that the inventory sheets accurately informed the FAs of the shares the Trading Desk was obligated to sell at a quoted price. Id. at 173-76.

Ortiz argues that the Division improperly faults him for the decisions of UBS senior executives. Id. at 7, 188. Ortiz contends that the decision to reduce inventory was rational, although he disagreed it was a sound business decision, and the method used to reduce inventory was the only one available. Id. at 7. He argues that the Trading Desk proceeded in an ethical and lawful manner to reduce inventory and relies on the Manning Rule as support. Id. at 7-8, 186-89. In the alternative, Ortiz argues that even if lowering Fund prices below open customer orders was wrong, Ortiz cannot be sanctioned because he sought, obtained, and reasonably relied upon advice of the Compliance Department and senior persons. Id. at 8-9. Ortiz informed persons at UBS and UBS PR that the Trading Desk was lowering prices to keep ahead of client open orders. Ortiz believes that senior management expressed his plans to reduce inventory. Id. at 8-9, 105-06, 187-88. Ortiz asserts that he was fully transparent with his supervisors, writing them a memorandum explaining that he would be lowering the prices below customer orders in order to achieve the inventory reduction. Id. at 8-9, 188-89. He contends he had a responsibility to, and did, notify the Risk Control Committee to consider if further disclosures were warranted. Id. at 9.

Finally, Oritz argues that he did not engage in a scheme to defraud investors or engage in deceptive conduct in furtherance of a fraudulent scheme, and the Division failed to prove its aiding and abetting claims. Id. at 284-313.

Legal Conclusions

As an initial matter, I GRANT the Division's motion to strike or disregard references in Briefs by Ferrer and Ortiz that they consulted with the Legal Department, which reviewed and approved their actions. Reply Br. at 1-3. This issue arose at the hearing, and my ruling stands. There are, however, references in the record to matters being shared with the Legal Department. Those references came into evidence without objection.

The huge amount of evidence detailed above is to resolve whether Ferrer, Ortiz, and UBS PR violated the antifraud statutes in 2008-2009, as the Divisions alleges.

1. Did Ferrer make misrepresentations and omissions to customers in an April 24, 2009, interview printed in *El Vocero* and in e-mails and memos he sent to FAs;

2. Did Ortiz make misrepresentations and omissions to customers at the March 31, 2009, Investor Conference and in his presentation to FAs on January 21, 2009;

3. Did UBS PR make misrepresentations and omissions to customers and FAs in the Fixed Income Fund VI prospectus, other prospectuses, the 2008 and 2009 Family of Funds brochures, and other documents that: (1) market forces such as supply and demand determined Fund prices; and (2) by stating it maintained a market in the Funds and intended to maintain a market in the Funds when, in fact, it had already stopped. Did Ferrer and Ortiz aid and abet these misrepresentations and omissions;

4. Did UBS PR make misrepresentations and omissions to customers: (1) by publishing a list of Fund prices in *El Vocero* and not disclosing that the prices included a 3% sales commission, were not trading prices, and where the prices often differed from what the Trading Desk offered; and (2) transmitting Fund prices that included indicative bids to another entity that used the information in customer account

statements as "actual market values." Did Ortiz aid and abet these misrepresentations and omissions;

5. Did UBS PR, Ferrer, and Ortiz engage in a fraudulent course of conduct and scheme and mislead customers and FAs when they represented the Funds as profitable, safe, and stable investments and represented that supply and demand were responsible for Fund prices; and

6. Did UBS PR, Ferrer, and Ortiz engage in a fraudulent course of conduct and scheme and mislead customers and FAs and violate their fiduciary duties to customers when they lowered Fund prices below open customer orders to sell UBS PR shares in inventory first.

Div. Br. at 127-28.

Securities Act Section 17(a)(1)-(3) makes it unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by use of the mails, directly or indirectly:

(1) To employ any device, scheme, or artifice to defraud; or

(2) To obtain 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; or

(3) To engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

Exchange Act Section 10(b) makes it unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange:

(b) To use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Exchange Act Section 15(c), in general, prohibits any broker or dealer from using the mails or any means or instrumentality of interstate commerce to effect any transaction in, or to induce or attempt to induce the purchase or sale of, any security by means of any manipulative, deceptive, or other fraudulent device or contrivance.

Exchange Act Rule 10b-5 makes it unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange:

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

To establish a violation of these antifraud provisions, the Division must establish that UBS PR, Ferrer, and Ortiz made material misrepresentations or materially misleading omissions, or committed a deceptive act as part of a course of action or scheme to defraud, in connection with the offer, sale, or purchase of securities, either acting with scienter or negligently. See SEC v. Pirate Investor LLC, 580 F.3d 233 (4th Cir. 2009); SEC v. Morgan Keegan & Co., 678 F.3d. 1233, 1244 (11th Cir. Ga. 2011) (citing SEC v. Merch. Capital, LLC, 483 F.3d 747, 766 (11th Cir. 2007)); SEC v. Steadman, 967 F.2d 636, 641-42 (D.C. Cir. 1992). Violations of Securities Act Section 17(a)(1), Exchange Act Sections 10(b), and 15(c), and Exchange Act Rule 10b-5 require a showing of scienter; Securities Act Section 17(a)(2)-(3) requires a showing of negligent conduct. See Steadman, 967 F.2d at 641 (citing Ernst & Ernst v. Hochfelder, 425 U.S. 185, 194 n.12 (1976); Aaron v. SEC, 446 U.S. 680, 686 n.5 (1980)); Gregory O. Trautman, Securities Act Release No. 9088 (Dec. 15, 2009), 97 SEC Docket 23492, 23523 n.70.

Scienter is a mental state consisting of an intent to deceive, manipulate, or defraud. Ernst & Ernst, 425 U.S. at 193 n.12. Scienter has also been described by the Supreme Court as a "wrongful state of mind." Dura Pharms., Inc. v. Broudo, 544 U.S. 336, 341 (2005).[58] Recklessness is defined as an extreme departure from standards of care such that the danger of misleading buyers or sellers is either known or so obvious that the person must have been aware of it. Steadman, 967 F.2d at 641-42. Negligence is defined as "the failure to exercise reasonable care." IFG Network Sec., Inc., Exchange Act Release No. 54127 (July 11, 2006), 88 SEC Docket 1374, 1389 (citing SEC v. Hughes Capital Corp., 124 F.3d 449, 453-54 (3d Cir. 1997)).

As I have noted in at least one prior decision, the case law calls for a reasonably broad approach on the concept of "in connection with." See John P. Flannery, Initial Decision Release No. 438 (Oct. 28, 2011), 102 SEC Docket 47903, 47941 n.63 (citing Dabit v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 395 F.3d 25, 37 (2d Cir. 2005) (the "in connection with" language in §10(b) and Rule 10b-5 must be read flexibly, not technically and restrictively so that novel and atypical as well as garden type variety frauds do not escape its prohibitive scope) (citing Superintendent of Ins.

[58] Scienter may be established by indirect evidence and may extend to a form of extreme recklessness. See Herman & MacLean v. Huddleston, 459 U.S. 375, 379 n.4 (1983) (noting that while the Supreme Court has not explicitly addressed the issue, it is the prevailing view of the appellate courts that reckless behavior may satisfy the scienter requirement); In re Cabletron Sys., Inc., 311 F.3d 11, 38 (1st Cir. 2002); In re Scholastic Corp., 252 F.3d 63, 74 (2d Cir. 2001).

v. Bankers Life & Casualty, 404 U.S. 6, 11 n.7, 12 (1971))). Adopting a reasonably broad interpretation of these facts, the actions of the CEO and the head of the Trading Desk of a large broker could be considered "in connection with" an offer, sale, or purchase of securities.

Liability for aiding and abetting and for causing can be proven by the following: (1) an independent securities law violation committed by a third party; (2) the person who aided and abetted and caused, knew that his or her role was part of an overall activity that was improper; and (3) the aider and abetter and causer knowingly and substantially assisted the conduct that constitutes the violation. See Woods v. Barnett Bank, 765 F.2d 1004, 1009 (11th Cir. 1985); see also Investors Research Corp. v. SEC, 628 F.2d 168, 178 n.61 (D.C. Cir. 1980). A respondent who aids and abets a violation also is a cause of the violation under the federal securities laws. See Sharon M. Graham, 53 S.E.C 1072, 1085 n.35 (1998), aff'd, 222 F.3d 994 (D.C. Cir. 2000).

It has not been shown by a preponderance of the evidence that Ferrer, acting with scienter or negligently, made misrepresentations or omitted material information to customers in an April 24, 2009, interview printed in *El Vocero* and in e-mails and memos sent to FAs.

The Division argues that Ferrer acted fraudulently because in the *El Vocero* interview and in his e-mails to FAs, he did not disclose "numerous material facts about, among other things, how UBS PR priced the Funds, the growing illiquidity in the secondary market, and the fact that UBS PR was dropping prices below open customers sell orders to achieve a mandatory inventory reduction." Div. Br. at 137. Examining each part of this claim shows it to be unpersuasive.

The main reasons why Ferrer's statements to *El Vocero* and his communications to FAs were not fraudulent are that: (1) the information was factually accurate, and (2) in these circumstances, there were no material omissions.

An objective reading of the *El Vocero* interview with Ferrer, supports Ferrer's position that his statements were about all mutual funds in Puerto Rico and the statements the Division finds objectionable were not about UBS PR Funds. Tr. 1226-29. I read the article as presenting Ferrer's position on how Puerto Rican investors fared compared with investors in the mainland United States during a period of financial stress. Since Ferrer was not specifically discussing the Funds, he cannot be faulted for omitting information about them.

The record supports Ferrer's claim that his communications with FAs were to motivate them to greater effort, which had been his standard operating procedure for a long time. Ferrer's e-mails and memos consisted of just a few lines and were obviously not meant to be a full blown analysis of the benefits and risks of owning Fund shares. One FA testified that he interpreted Ferrer's e-mails as motivational; he did not forward the e-mails or repeat their contents to clients.[59] Tr. 2802-03, 2806-07. No FA ever told Belaval he felt pressure from Ferrer to sell Fund shares. Tr. 224. If Ferrer considered these communications to be directives, one would expect that that he would check whether they had the desired result. There is no evidence that he did.

[59] Two FAs who testified for the Division had been terminated by UBS PR. Tr. 1558, 2056-57.

The persuasive evidence is that for certain investors during the relevant period the Funds were an attractive investment. They paid higher returns than other comparable investments, had significant tax advantages for Puerto Rico residents, consistently paid monthly interest, and had a dividend reinvestment policy that benefited investors. Tr. 2087, 2220; Ortiz Ex. 201 at 13-14. A key reason the Funds were attractive to investors is that they consistently paid high dividends even in periods of market imbalance. Tr. 152-53. For example, as of the end of October 2008, all the Funds were paying dividends of between 6% and 7%. Tr. 149-51. The Funds have never missed a dividend payment. Tr. 154. In 2008, Fund dividend yields were between 3.5% and 6.7%, and total returns were between -2.5% and 15.6%. Ortiz Ex. 282. Asset Management expected that "[d]ividends will continue to increase in relation to increased earnings." Tr. 1313-14; Ferrer Ex. 628 at 9.

Ubinas, Belaval, and others were providing the same message as Ferrer – the Fund shares were a good investment for certain investors in 2008-2009. Belaval was not surprised by Ferrer's many communications to the FAs during the relevant period, which "ask[ed] the sales force to focus on the funds, because [Ferrer] had a strong belief – as did I and, basically, all of [UBS PR] top management – that this particular point in time was a great opportunity for investors to be coming in." Tr. 223. Price thought that 2009 was a good time to buy the Funds because the yields were superior to comparable financial instruments even on a taxable basis and on non-tax basis they were even more attractive. Tr. 2611-12. The testimony set out in the Facts shows that many of the FAs who testified advised their customers not to sell their Fund shares because they were a good investment.

The record shows that information on how UBS PR priced the Funds was available to FAs from multiple sources, including the prospectuses, the 2008 and 2009 brochures, weekly sales meetings, BOM, the Trading Desk, and that UBS PR was an open environment where FAs were encouraged to work in teams, communications with the Trading Desk were frequent, and Ferrer wanted the FAs to have more information. Div. Exs. 10, 11, 31, 123; Ortiz Exs. 214-16; Ferrer Exs. 500-22, 625-27. Ferrer had nothing to do with pricing the Funds so he did not make any material omissions by failing to discuss pricing in his communications to FAs who were knowledgeable, or should have been, on the subject.

In addition to their knowledge of pricing, the overwhelming evidence is that the FAs knew about growing illiquidity in the secondary market, and they knew UBS PR was dropping Fund prices below open customer sell orders. What was occurring was obvious. The Division's expert witness understood UBS PR's increasing use of indicative bids, the reduction of inventory, and the unexecuted sales orders, to suggest that UBS PR was withdrawing support for the Fund market. Div. Ex. 153 at 10. FAs knew that UBS PR was acting to reduce inventory, but they did not know it was the result of an order from UBS.

Belaval, who was a credible witness, testified that he was candid with FAs and that the word spread about the inventory reduction. Tr. 176-78, 255-56. However, most of the FA testimony is that they believed UBS PR stopped buying shares and serving as a liquidity provider because of low demand. It is my judgment that UBS PR did not have to disclose to FAs or customers the policy disagreement it had with UBS that caused it to take the actions which were obvious to all and which, in fact, were caused by lack of demand for Fund shares.

On January 15, 2009, after Ferrer became aware of an FA's complaint about falling Fund prices, he e-mailed Ortiz and BOMs:

> I understand that bids have to follow market conditions, but everyone has to understand why bids change dramatically over a short time span. This has not been done sufficiently, it seems.
>
> The [FAs] must receive the appropriate justifications time and again so they believe.
>
> If not, we will pay the consequences the less activity. I suggest another set of meetings in the branches.
>
> Please include [Belaval] whenever possible.

Tr. 1469-70; Div. Ex. 97. Rather than trying to misrepresent or omit material information with the intent to deceive, manipulate, or defraud, Ferrer was requesting more meetings to encourage understanding.

It was UBS PR's standard operating procedure for Compliance to review the e-mails of executives. In only one instance did Compliance advise Ferrer to add a disclaimer and he quickly did so even though he did not think it was necessary. Finally, Ferrer should not be held liable for omitting material information to FAs because Belaval, not Ferrer, was responsible for disclosing material information about the Funds to investors and making sure that FAs and CSAs made appropriate disclosures to clients.

For all the reasons stated, I find that Ferrer did not violate the antifraud provisions in an April 24, 2009, interview printed in *El Vocero* and in e-mails and memos sent to FAs.

<u>It has not been shown by a preponderance of the evidence that Ortiz, acting with scienter or negligently, violated the antifraud provisions of the securities statutes in his presentation to FAs on January 21, 2009, or in his presentation to FAs and customers at the March 31, 2009, Investor Conference.</u>

Ortiz's January 21, 2009, presentation

The basis for the Division's January 21, 2009, allegation is a PowerPoint presentation that Ortiz delivered at a sales meeting of FAs at a branch office. Ortiz Ex. 282. It appears that slides were given to BOM Colon, and FAs Juan Gonzalez, Eric Snyder, and Angel Canabal with the disclaimer that they were for internal use only and could not be sent to clients following Ortiz's in-person delivery. <u>Id.</u> Ortiz testified that he made the same presentation at various branch offices either in person or by phone. Tr. 710. There are 4 slides: (1) Closed End Funds - 2008 Performance

Review; (2) Closed End Funds - Current Yields; (3) Closed End Funds - Market Conditions; and (4) Closed End Funds - Outlook. Ortiz Ex. 282.

The Division does not claim that Ortiz's presentation was false; rather that: (1) it "hardly painted a picture of the market Belaval described as the most extended period of supply and demand imbalance in the Funds' history, and which Ortiz described as the most difficult in his 28 years in the industry;" and (2) "nowhere did the presentation discuss that supply had exceeded demand since May of 2008, that the desk had consistently requested inventory increases above historical limits for the previous several months to maintain liquidity in the market, the continuing problems with dividend reinvestment shares, or the detailed problems with the market Ortiz had described to Ferrer just a week earlier." Div. Br. at 60.

In my judgment, Ortiz did not fail to disclose material information with an intent to deceive or defraud, nor did Ortiz act negligently. The nature of the audience is significant in assessing the allegation. Ortiz was presenting to people who made their living advising clients on securities. The FAs he was talking to received daily inventory sheets showing increases. At this time, the GTC book was not distributed to FAs, it was maintained by Rosado, but there is no evidence that he did not disclose marketable orders to FAs who were looking to execute riskless transactions. Tr. 75. The FAs had much of the information that Ortiz had. What they did not know is that he and others at UBS PR disagreed with UBS's position on the inventory levels.

The information in the presentation was accurate and Ortiz testified his purpose was "to stand in front of [the FAs] and give them our view of market conditions." Tr. 710. One Division complaint is that Ortiz did not state that supply had exceeded demand for the Funds since May 2008, however, the PowerPoint slides do state that "Prices have dropped due to a supply and demand imbalance." Ortiz Ex. 282. The testimony shows that the FAs were concerned about liquidity and that liquidity was often the subject of the FAs weekly sales meetings. If any FA had questions about the subjects the Division claims Ortiz omitted, they were free to ask Ortiz about them. I consider it significant that Ortiz made himself available to answer questions and there is no evidence that he refused to answer any inquires or provided false answers.

Ortiz's March 31, 2009, presentation

The basis for the Division's March 31, 2009, allegation of fraud is another PowerPoint presentation in which the Division alleges Ortiz made fraudulent and misleading representations and omissions to FAs and investors. Ortiz spoke for 10 to 12 minutes using a PowerPoint presentation with 6 slides.[60] Tr. 770; Div. Ex. 21; Ortiz Ex. 304 at 57. The Division claims that Ortiz:

> Touted the [Funds'] liquidity and prices by presenting misleading information showing trading volumes and prices had increased from 2006 through 2008;
>
> . . .

[60] A description of Ortiz's presentation at the March 31, 2009, Investor Conference is in the Findings of Fact.

> Falsely portrayed the Funds as liquid-trading investments by showing increasing trading volumes, and highlighted the consistent level of closed-end fund trading activity in 2008;
>
> . . .
>
> Failed to disclose that less than two weeks earlier, UBS had ordered [Ortiz] and UBS PR to reduce inventory from $50 million to $30 million.

Div. Br. at 129-30.

The Division's position is that Ortiz was obligated to inform investors and FAs that: (1) in March 2009, UBS had refused his request to temporarily raise the Funds' inventory level to $50 million and told him to return the Funds' inventory to the $30 million level; (2) Fund market conditions were difficult; and (3) Fund liquidity was a problem. The Division does not contend that Ortiz communicated false information during his presentation. Div. Br. at 74, 76, 129-30.

The Division also claims that Ortiz's "purported statement at the end of his presentation that 'the level of trading activity . . . did not mean that this market did not go through periods of limited liquidity,'" was misleading because it did not disclose actual market conditions – the longest and most difficult period of market imbalance in the Funds' history. Id. at 129-30. Finally, the Division charges that Ortiz's statement that the Funds had "experienced a small price increase from January 2007 to February 2009 despite challenging conditions in U.S. municipal and U.S. closed-end fund markets" was misleading because it failed to disclose that he and UBS PR had been dropping prices in 2009 because of excess supply over demand. Id.

In my judgment, Ortiz's presentation on March 31, 2009, did not constitute an act of fraud, a very serious violation of the securities statutes. See Marshall E. Melton, 56 S.E.C. 695, 713 (July 25, 2003), ("[W]e recognize that conduct that violates the antifraud provisions of the federal securities laws is especially serious and subject to the severest of sanctions under the securities laws.").

The reasons for my conclusion that Ortiz did not make any material misstatement or omission in his March 31, 2009, presentation follow. First, it is significant that the Funds were marketed as long-term investments. The Fund prospectuses, brochures, and literature all contained caveats that illiquidity was one of the risks of Fund ownership, and given the information available to FAs and investors, Ortiz not did not violate the antifraud provisions by not discussing present day market liquidity and the Risk Committee's directive to reduce inventory in a 10 to 12 minute presentation at a sales conference.

Second, context is important. Ortiz spoke for 10 to 12 minutes as part of a 75 to 90 minute presentation to a group of FAs and investors, and spent half his time discussing municipal bonds and the other half on the Funds. Tr. 772. Ortiz was not engaged in a one-on-one discussion with a customer looking to make an investment decision where UBS PR's guidelines and instructions to FAs mandated a discussion about risk.

Moreover, risk was mentioned right before Ortiz began his presentation. The last page of the PowerPoint presentation preceding Ortiz's presentation described one of the Funds' risk factors from the 2008 Family of Funds' brochure which states:

> While [UBS PR] currently intends to maintain a market in fund shares, it is under no obligation to do so. Therefore, there may be occasions when you will be unable to sell your shares or will be able to sell at a loss or at times at a significant loss.

Ortiz Ex. 304 at 56.

The evidence shows general agreement that securities dealers do not typically discuss publicly the plans of their Trading Desk; therefore, Ortiz cannot be held liable for not revealing the Trading Desk's position that it had to lower prices to reduce inventory. Tr. 2314-15, 2582, 2654-55; Ortiz Ex. 201 at 5-6; Ferrer Reply Br. 60-61. It appears that the Trading Desk had lowered Fund prices in prior periods of market imbalance. Tr. 167, 664-65.

Ortiz was a credible witness. This conclusion is based on observing his demeanor during almost two full days of testimony and reviewing the consistency of his testimony with other evidence in the record. My conclusion is supported by unanimous testimony from people who worked for him and his superiors in Puerto Rico and Weehawken who respect him for his hard work and ethical standards. UBS PR's compliance manager testified, "when I dealt with Mr. Ortiz, I felt there was, you know, a great amount of integrity there." Tr. 2481. I accept as valid Ortiz's testimony that:

> As I finished my presentation, I said to investors that the level of trading activity that were reflected in the slides they had just seen did not mean that this market did not go through periods of limited liquidity. I used the term, if I remember correctly, permodos de iliquidez. Periods of illiquidity is the expression that I used, but in Spanish. But it's a presentation that we give in Spanish even though the slides are in English.
>
> So I said that this market went through periods of illiquidity. And what that meant was that during those periods investors had to wait and they could not always sell their investments at the prices they wanted. So we in fact were going through one of those periods.

Tr. 775.

Finally, it is unreasonable to make a fraud finding against an individual based on half of a 10 to 12 minute presentation when his activities were scrutinized over a two-year period and the allegation is the omission of information, most of which was knowable to FAs and others who observed the market for Funds.

<u>UBS PR did not make misrepresentations or omissions to customers or FAs in prospectuses, brochures, or other documents.</u>

The Division alleges that UBS PR made material misrepresentations or omissions to customers and FAs in the Fixed Income Fund VI prospectus, other prospectuses, the 2008 and 2009 Family of Fund brochures, and other documents by stating that: (1) market forces such as supply and demand determined Fund prices; and (2) it maintained a market in the Funds and intended to maintain a market in the Funds when, in fact, it had already stopped.

The Division alleges that UBS PR's desire to maintain constant yields and stable prices determined prices, and that UBS PR made untrue statements which caused FAs to believe that Fund shares were priced according to supply and demand. Div. Br. at 28-33. "If there were more sellers than buyers, prices would go down and vice versa." Div. Br. at 27. As the basis for this allegation, the Division cites the following:

> The 2008 Family of Funds brochure: "The market price of a closed-end fund's shares may trade at a premium or discount to NAV. The price is determined by how much buyers are willing to pay or sellers are willing to accept and how the fund is performing compared to similar investments, and not primarily by the NAV of the Fund's holdings."
>
> The 2009 Family of Funds brochure: "The market price of a closed-end fund's shares may trade at, below or above NAV. The prices provided by the [UBS PR] Trading Desk are based on how much buyers are willing to pay or sellers are willing to accept and how the fund is performing compared to similar investments, and not primarily by the NAV of the fund's holdings."
>
> UBS prospectuses: "*Market Price of Shares.* The market price of the Shares will be determined by such factors as relative demand for and supply of the Shares in the market, general economic conditions, and other factors beyond the control of the Fund."
>
> A December 11, 2008, e-mail from Rosado responding to an FA's complaining about price reductions, "This is called supply/demand issue."

Div. Br. 26-27 (emphases omitted).

The Findings of Fact section sets out most of the evidence on pricing Fund shares. That evidence does not support the Division's apparent position that the Trading Desk's first or sole consideration in setting prices was to keep yields constant and prices stable. The evidence is consistent that the Trading Desk considered a number of factors with supply and demand and yield as the key ones. These representations by Ferrer to a top producing FA on June 8, 2009, that "there continues an imbalance between supply and demand, therefore prices continue to fall until finding equilibrium," supports the importance of supply and demand in setting prices. Tr. 1239, 1489; Div. Ex. 79.

The Division cites the testimony of a single FA, Del Valle, as support for its position that FAs understood that the Trading Desk represented that "the only basis to price the funds were supply and demand" so that if there were more sellers than buyers, prices would go down and vice versa. Tr. 1660; Div. Br. at 27. The testimony of one FA is not persuasive that all, or even a majority of FAs, understood that prices were set solely on supply and demand. In addition, Del Valle's testimony is not persuasive because he had been terminated by UBS, engaged in FINRA litigation about his discharge and prevailed, and he contradicted himself on some matters.

When UBS forced UBS PR to reduce inventory and there were more sellers than buyers in Fund shares, the Trading Desk could not make a market in the shares of certain Funds. I do not find that when this happened, UBS PR made material misstatements or omissions for stating in Fund prospectuses and brochures that:

> UBS Puerto Rico currently intends to maintain a market in the Shares, although it is not obligated to do so, and may discontinue such activities at any time. No assurance can be given as to the liquidity of the market for the Shares as a result of such activities by UBS Puerto Rico. If UBS Puerto Rico's activities are discontinued at any time, there may be no other market for the Shares.

Div. Ex. 22 at Bates 1254; Ortiz Ex. 201 at 12-13.

> [UBS PR] currently intends to maintain a market in [Fund] shares, and has since 1995, [but] it is under no obligation to do so. Therefore there may be occasions when [customers] may be unable to sell shares or will be able to sell them at a loss or at times a significant loss.

Ferrer Ex. 543 at 3, 7. As detailed in the Findings of Fact, when the Trading Desk decided it could not make a market in a Fund, it communicated this information clearly to all FAs through the daily inventory sheets, the size of GTC book orders, and in conversations with the Trading Desk. In addition, all through this period, weekly sales meetings were attended by FAs, BOMs, and sales managers, and often Belaval or his deputy. Tr. 186-87.

UBS PR did not make material misrepresentations or omissions to customers and FAs in 2008 and 2009.

The Division alleges that UBS PR violated the antifraud provisions by: (1) publishing a list of Fund prices in *El Vocero* and not disclosing that the prices included a 3% sales commission, were not trading prices, and that the prices often differed from what the Trading Desk offered; and (2) transmitting Fund prices that included indicative bids to another entity that used the information in customer account statements as "actual market values."

El Vocero showed information in columns for various securities including the Funds for which it showed NAV, Precio (price), and Yield. Div. Ex. 54. According to Ortiz, the Funds' price information that appeared in *El Vocero* was the maximum offer price at which the Trading Desk had been willing to sell shares during the preceding week and included a 3% commission. Tr. 324-28. The Division put in the record numerous occasions when on the same day the price in *El*

Vocero was different than the price on an inventory sheet plus a 3% commission. Tr. 331-40. Ortiz testified that the prices would never correspond with each other; it was impossible. Tr. 333, 340.

The Trading Desk furnished end-of-month bid prices to the UBS Pricing Department, which included them in customer account statements as per share prices. Tr. 340, 884. Some of the prices reflected indicative bids. Tr. 340, 885. Customers were not informed that some of the share prices were based on indicative bids, not firm prices.

The evidence is not persuasive in either situation – the price information that appeared in *El Vocero* and in customer statements – that UBS PR acted with scienter or negligently to defraud investors. I accept the testimony of Belaval, a credible witness, that:

> I'm not sure whether these prices were given Thursday or Friday. It was either late Thursday or Friday, and they were posted Monday. So this was meant to provide the public an indication of where the securities were valued the prior week, not something that they would expect to be able to use in a trading environment.
>
> . . .
>
> It was intended to provide the market an indication of where the products were trading the prior week.

Tr. 51, 54. Belaval pointed out that the information for the common shares of securities shown in *El Vocero* next to the Fund reported previous day share prices and did not indicate that people would be able to buy those shares on the following day. Tr. 55.

The publication in *El Vocero* did not constitute a material misrepresentation or omission to customers by UBS PR because it would be naïve for someone to think that a newspaper report of a security's price was a firm offer to sell the security at that price, and the only way a customer could have bought or sold Fund shares is through an FA who would determine the price with the Trading Desk and decide on the level of the commission.

The use of indicative bids on customer statements as share prices is unusual; however, in this closed-end fund market situation, where UBS PR did not have a firm bid, the indicative bid was the best estimate of the share's value. Also, account statements had a section, Important information about your statement, that read:

> Price/Value. The closing prices and/or mean bid and ask prices of the last recorded transaction of all listed securities, options and OTC NASDAQ securities, when available. Less actively traded securities may be priced using a computerized valuation model and may not reflect an actual market price or value.

Div. Ex. 101 at Bates 0019. Pluchino testified that there was general disclaimer language on the back of UBS PR's customer account statements in 2008-2009, and that since that time, UBS PR has modified that language to state that the prices on the account statement reflect its opinion of what the shares are worth. Tr. 2472-74. Finally, not a single UBS PR customer testified that he/she believed the account statement was false or misleading.

For all these reasons, I find that the Division did not show that UBS PR committed antifraud violations by making material misrepresentations or omissions to customers and FAs by: (1) publishing a list of Fund prices in *El Vocero* and not disclosing that the prices included a 3% sales commission, were not trading prices, and that the prices often differed from what the Trading Desk offered; and (2) transmitting Fund prices that included indicative bids to another entity that used the information in customer account statements as "actual market values."

UBS PR, Ferrer, and Ortiz did not engage in a fraudulent course of conduct or a scheme and did not mislead customers and FAs when they represented the Funds as profitable, safe, and stable investments, and that supply and demand were responsible for Fund prices.

The Division claims that:

> UBS PR, Ferrer, and Ortiz all participated in a fraudulent scheme that deceived investors into purchasing and holding [closed-end funds] in 2008 and 2009, and caused them losses by delaying and preventing them from selling their Fund shares in 2009. Keeping customer demand high for the Funds allowed UBS PR to keep its "powerful profits driver" going, which allowed all the UBS entities in Puerto Rico to make money. Among other things, UBS PR issued new Funds and collected underwriting and sales load fees, FAs got increased commissions, and the UBS Trust Company collected lucrative, recurring fees for managing the Funds.

Div. Br. at 160.

The Division specifically refers to the deceptive acts in furtherance of the scheme to be: (1) representations in the prospectuses and brochures that market forces out of the firm's control, such as supply and demand determined Fund prices; (2) Ferrer and Ortiz misrepresented to FAs that supply and demand and other market forces determined market prices, and did not disclose it was pricing shares so it could compete with customer orders; (3) UBS PR misrepresented in the 2009 Family of Funds brochure and prospectuses that it intended to continue maintaining a market in the Funds; and (4) that UBS PR falsely represented Fund prices in *El Vocero*. Div. Br. at 161-62.

The term fraudulent course of conduct and scheme has a specific meaning and implies complicity in an illegal strategy. At its most basic, a scheme is "[a]n artful plot or plan, used to deceive others." Black's Law Dictionary 1346 (7th ed. 1999). A fraudulent course of conduct or scheme has been described as a situation where the person engages in "conduct that had the principal purpose and effect of creating a false appearance of fact in furtherance of the scheme." See SEC v. Brown, 740 F. Supp. 2d 148, 172 (D.D.C. 2010) (quoting Simpson v. AOL Time Warner Inc., 452 F.3d 1040, 1048 (9th Cir. 2006), vacated on other grounds, Avis Budget Group, Inc. v. Cal. Teachers' Ret. Sys., 552 U.S. 1162 (2008)).

Each Fund prospectus contained language similar to the following:

> UBS Puerto Rico currently intends to maintain a market in the Shares commencing after the final closing of the initial public offering of the Shares, although it is not obligated to do so. No assurance can be given as to the liquidity of, or the trading market for, the Shares as a result of any activities undertaken by UBS Puerto Rico. Such purchases and sales, if commenced, may be discontinued at any time. If at any time UBS Puerto Rico, and other dealers, if any, cease to maintain a market, the Shares will become illiquid until a market is reestablished.
>
> . . .
>
> *Market Price of Shares* The market price of the Shares will be determined by such factors as relative demand for and supply of the Shares in the market, general economic and market conditions, and other factors beyond control of the Fund. The Fund cannot predict whether shares will trade at, below, or above [NAV] or their respective offering price.

Div. Ex. 31 at 9. Both Fund brochures contain similar language. Div. Exs. 10 at 7, 11 at 3; Ferrer Exs. 500-22.

In addition, the 2008 Fund brochure stated that, "Market factors such as supply and demand and the yield of similar products determine the price of the closed-end fund shares." Div. Ex. 10 at 3. Also,

> The market price of fund shares is based on relative demand and supply of the shares as well as other factors, including the general market and economic conditions in the Prospectus. Accordingly the value of your investment in the funds will fluctuate and the price that you are able to obtain for your shares may be less than the [NAV] of the shares and may be less than the price that you paid in purchasing fund shares.

Div. Ex. 10 at 7.

The 2009 Fund brochure stated:

> The [UBS PR] Trading Desk uses market factors, including, but not limited to supply and demand and the yield of similar types of products to price closed-end fund shares.

Div. Ex. 11 at 2.

Michel reported to UBS's Executive Committee on March 30, 2009:

> UBS's closed-end Puerto Rico Mutual Funds are not traded on any exchange and UBS acts as the sole liquidity provider for these funds with no obligation to maintain

> a market (which is adequately disclosed to clients via the prospectus). Because there is not a public market, shares are purchased by the trading desk based on "market" values established by the Firm. In the current environment, those values, in general, are priced at a premium to net asset value.

Div. Ex. 47.

I find UBS PR's representations in its prospectuses, brochures, and literature to be true. UBS PR made a market in Fund shares to aid liquidity that it was not obligated to do. For a time in 2008 and 2009, the excess of supply over demand caused UBS PR to exercise the right that it had put everyone on notice it had, to cease buying Fund shares into inventory and to reduce share prices to sell inventory. Riskless Fund transactions continued, but the Risk Committee ordered an inventory reduction, which temporarily sidelined UBS PR as a buyer of Fund shares.

There is not one bit of evidence that UBS PR, Ferrer, and Ortiz engaged in a course of conduct to mislead or a scheme to mislead investors by hiding or disguising the fact that UBS PR was in a period when it was not buying Fund shares and was reducing Fund share prices. The Trading Desk did not, and could not, keep its activities secret. FAs knew what the Trading Desk was doing through the inventory sheets, in phone conversations with the Trading desk, in weekly sales meeting held in the branches, and communicated this information to customers. Every customer had to communicate with an FA to buy or sell Fund shares. The evidence shows some days on which indicative bids were posted for all 23 Funds, but the evidence is that trading activity in the Funds continued. As has been noted, Price, Ferrer, Ubinas, Belaval, and some FAs considered the Funds to be profitable, safe, and stable investments during this period.

The Division's second charge, that Ferrer and Ortiz misrepresented to FAs that supply and demand and other market forces determined market prices, and they failed to disclose that the Trading Desk was pricing shares so it could compete with customer orders, are both unpersuasive. The Trading Desk was forced to reduce share prices to reduce inventory because of lack of demand for Fund shares, the root cause of the problem, which caused inventory to rise above the level allowed by the parent company. The Division believes that something was wrong because the Trading Desk did not more or less automatically reduce Fund prices to reflect falling demand. The testimony of its expert showed anomalies in premiums over NAV in Fund shares compared to other closed-end funds and how these anomalies increased in 2008 and 2009. However, the unanimous evidence is that there is not one right way of pricing closed-end funds. Both experts acknowledged this fact, and the Division's expert acknowledged that one of the most consistent anomalies in modern capital markets is why closed-end funds trade at discounts at times and premiums at times. Tr. 2287-88. Finally, as discussed previously, the Trading Desk was not required to reveal its trading plans, and there were no false representations made via *El Vocero*.

The record shows that the closed-end Fund market in Puerto Rico was unique, but that it was based on the peculiarities of that sui generis market. The Fund situation was odd compared to other securities in other markets, but the preponderance of the evidence is that in 2008-2009, there was a solid factual basis which showed the pricing of Fund shares to be proper and legitimate. For these reasons, I do not find that the preponderance of the evidence supports the

Division's allegation that UBS PR, Ferrer, and Ortiz engaged in a fraudulent course of conduct or a scheme to mislead customers and FAs when they represented the Funds as profitable, safe, and stable investments and that supply and demand were responsible for Fund prices.

UBS PR, Ferrer, and Ortiz did not engage in a fraudulent course of conduct and scheme or mislead customers and FAs and violate their fiduciary duties to customers when they lowered Fund prices below open customer orders to sell UBS PR shares in inventory first.

The Division contends that UBS PR was not authorized or required by the Manning Rule, set out in FINRA Regulatory Notice 08-49, to lower Fund prices below open customer orders in order to sell UBS PR shares in inventory from March-September 2009. The Division maintains that the Manning Rule required UBS PR to act as a fiduciary for customers and when it accepted their orders, it had to "observe high standards of commercial honor and just and equitable principles of trade." Div. Br. at 168-69.

UBS PR's trading policy, in place since 2006, incorporated its understanding of the "Manning" obligation, i.e., the firm cannot trade for its own account at a price that would satisfy a client order. Tr. 524, 529; Div. Ex. 150. A document, UBS Puerto Rico Secondary Market Order Handling and Trading Guidelines, Closed-end Funds, which appears to be from May 2007 states:

> NASD Rules forbid the Trading Desk, when it accepts and holds a customer's market order or limit order, from trading for its own account at prices that would satisfy the market or limit order, unless it immediately executes the order.

Div. Ex. 94 at 6.

Compliance advised Ortiz that the Trading Desk could not execute a sale out of inventory if a client's order was at that price, but it could execute a sale out of inventory so long as the Trading Desk's price was lower than a current client order to sell price. Tr. 2467-68. Ortiz testified that he believed UBS PR always had to have the lowest price in order to be able to sell shares from inventory. Tr. 474. Given this restriction, the only way the Trading Desk could sell inventory quickly was to lower share prices below pending customer orders that had not been executed. Given the disclosures contained in the prospectus, brochures, and other literature, and its own trading practices, it was lawful for UBS PR to post firm bids that were below an open marketable customer order.

For these reasons, UBS PR, Ferrer, and Ortiz did not engage in a fraudulent course of conduct and scheme, mislead customers and FAs, and violate their fiduciary duties to customers by, when following established trading guidelines, lowering Fund prices below open customer orders to sell shares from inventory.

Because I found no primary violations, all the aiding and abetting and causing charges do not stand.

Record Certification

Pursuant to Rule 351(b) of the Commission's Rules of Practice, 17 C.F.R. § 201.351(b), I certify that the record includes the items set forth in the Record Index issued by the Secretary of the Commission on October 10, 2013, with the addition of Division Exhibit 98, which the parties agreed to but which I inadvertently left off the exhibit list.

Order

I find that no remedial action is appropriate pursuant to Section 8A of the Securities Act of 1933, Sections 15(b) and 21C of the Securities Exchange Act of 1934, and Section 9(b) of the Investment Company Act of 1940, and I ORDER that the proceeding is DISMISSED.

This Initial Decision shall become effective in accordance with and subject to the provisions of Rule 360 of the Commission's Rules of Practice, 17 C.F.R. § 201.360. Pursuant to that Rule, a party may file a petition for review of this Initial Decision within twenty-one days after service of the Initial Decision. A party may also file a motion to correct a manifest error of fact within ten days of the Initial Decision, pursuant to Rule 111 of the Commission's Rules of Practice, 17 C.F.R. § 201.111. If a motion to correct a manifest error of fact is filed by a party, then that party shall have twenty-one days to file a petition for review from the date of the undersigned's order resolving such motion to correct manifest error of fact. The Initial Decision will not become final until the Commission enters an order of finality. The Commission will enter an order of finality unless a party files a petition for review or motion to correct manifest error of fact or the Commission determines on its own initiative to review the Initial Decision as to a party. If any of these events occur, the Initial Decision shall not become final as to that party.

____

Brenda P. Murray
Chief Administrative Law Judge