**UNITED STATES OF AMERICA**
**Before the**
**SECURITIES AND EXCHANGE COMMISSION**
**September 14, 2012**

**Administrative Proceeding**
**File No. 3-14862**

**In the Matter of**

**MIGUEL A. FERRER, and**
**CARLOS J. ORTIZ,**

**Respondents.**

# DIVISION OF ENFORCEMENT'S PREHEARING BRIEF

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## TABLE OF CONTENTS

## TABLE OF AUTHORITIES

**CASES** Page

**FEDERAL STATUTES**

**RULES**



**OTHER AUTHORITIES**

## I. INTRODUCTION

This matter concerns the instrumental role of two senior officers of UBS Financial Services of Puerto Rico in a fraudulent scheme involving 23 closed-end mutual funds that were the firm's largest revenue producer. For much of 2008 and early 2009, UBS artificially propped up closed end fund ("CEF") prices to deceive investors into believing a liquid and stable CEF trading market existed. However, in March 2009, UBS' parent corporation determined the firm's growing CEF inventory represented a significant financial risk, and ordered the subsidiary ("UBS PR") to get rid of 75 percent of the inventory.

Over the next several months, UBS PR complied, dumping millions of dollars of CEF shares on the market by dropping prices and undercutting sell orders from the firm's own customers trying to exit the market. At the same time, UBS PR continued to misrepresent the Funds as stable, liquid, and profitable investments while stepping up efforts to solicit customer buying. By September 30, 2009, thousands of UBS PR's customers, the majority of whom were elderly and unsophisticated investors, had lost more than $600 million in value off their CEF investments.

UBS PR Chairman Miguel A. Ferrer, and the head of its CEF trading desk, Carlos Juan Ortiz, were an integral part of the scheme. Ortiz, as UBS PR's Managing Director of Capital Markets, made all CEF pricing and trading practice decisions during 2008 and 2009. Ortiz was aware in 2008 of plummeting investor demand for the Funds and a growing number of customers trying to sell their holdings. But rather than lower CEF share prices to keep them in line with supply and demand, Ortiz decided UBS PR should buy investors' CEF shares into inventory to keep both prices and yields stable and consistent, thereby deceiving investors into believing a healthy and active Fund trading market existed. At the same time, Ortiz knew UBS PR was falsely claiming market forces such as supply and demand determined CEF share prices. He also knew UBS PR was not telling investors the firm was using its inventory account to prop up prices and create liquidity, or telling investors they faced a significant risk of not being able to sell their shares in an increasingly illiquid market.

Ortiz played a similar central role in UBS PR's 2009 inventory dump. He was the recipient of instructions from UBS PR's parent firm to quickly and substantially reduce the company's CEF inventory. Despite frequently acknowledging the harm this forced selling was doing to customers, Ortiz designed and implemented a plan he named "Objective Soft Landing," in which UBS PR repeatedly lowered its Fund share prices below those of customers' sell orders so the firm could sell its shares ahead of its customers. At the same time, Ortiz's trading desk stopped entering firm buy orders, essentially withdrawing its support of the CEF secondary trading market.

Ortiz knew UBS PR was not disclosing the reason for falling share prices to investors, and the firm was not telling customers it was, for the most part, no longer in the market to buy CEF shares. Compounding his fraud, Ortiz misrepresented the Funds as a stable, profitable and liquid-trading investment to more than a thousand investors at a March 31, 2009 conference.

Ferrer was equally culpable in the fraudulent scheme. Ortiz and others made Ferrer fully aware throughout 2008 of the growing illiquidity in the CEF trading market. Knowing CEF sales represented the single largest portion of UBS PR's revenues, Ferrer pressured Ortiz and his trading desk to "fix" the problems and implement plans to facilitate customer buying – all without disclosing the significant selling logjam that existed. Additionally, Ferrer directed UBS PR to move ahead with two new primary offerings of CEF Funds – even in the face of questions from the company's own financial advisors about why the firm was promoting sales of new Funds when the existing trading market was saturated.

To ensure UBS PR customers bought new and existing Funds, Ferrer pushed the company's financial advisors to heavily promote CEF sales throughout the summer and fall of 2008. He repeatedly told financial advisors the Funds were attractive and profitable investments – using such glowing terms as "superior performance," "attractive returns," "stellar performance," "our Funds are doing fine," and "low volatility," and pushed them to tell their clients the same things. He failed to disclose to the financial advisors that virtually the only buyer of CEF shares was UBS PR's inventory account, and there was a significant risk customers would not be able to sell their shares. Ferrer's misstatements and omissions ensured that financial advisors – who for the most part did not know the scope of the market illiquidity – misrepresented the Funds' profits, safety and stability to customers.

Ferrer's conduct also misled financial advisors and, ultimately, customers, during the 2009 inventory dump. He was well aware of the orders to sell inventory and UBS PR's strategy of reducing CEF prices to achieve compliance. In fact, he strenuously objected to the parent company's orders in numerous emails to senior executives, accusing them of disrupting the CEF trading market and causing customers hundreds of millions of dollars in losses. Yet despite this, he again touted the purported strength and profitability of CEF investments to financial advisors and the investing public.

In emails and a newspaper interview, he used similar glowing terms to describe the Funds, while never disclosing the truth to financial advisors or investors about the existing problems with the CEF trading market and the substantial risk that anyone investing while UBS was dumping its inventory would lose money. At least one of Ferrer's emails to financial advisors describing the strength of the Funds was so misleading it drew the ire of UBS PR's compliance department.

The conduct, misrepresentations and omissions of Ferrer and Ortiz should result in the Law Judge finding them liable for violating Section 17(a) of the Securities Act of 1933 ("Securities Act"), and Section 10(b) and Rule 10b-5 of the Securities Exchange Act of 1934 ("Exchange Act"). Additionally, the Law Judge should find them liable for aiding and abetting UBS PR's violations of those sections of the Securities and Exchange Acts, as well as the firm's violations of Exchange Act Section 15(c). The Law Judge should impose sanctions as discussed in more detail below.

The Division of Enforcement expects Ferrer and Ortiz to claim the Law Judge cannot hold them liable for these securities law violations because of their limited direct contact with investors. However, for reasons we describe more fully in our legal memorandum below, this argument exhibits a misunderstanding or misstatement of the securities laws. The Law Judge can find Ferrer and Ortiz liable in at least three different ways.

First, the law is clear an individual may be directly liable for false statements or material omissions even if *his* statements never reached a single investor. We explain in more detail below that because certain misstatements of Ferrer and Ortiz resulted in fraud on investors, they may be directly liable for securities fraud. Second, the misrepresentations, omissions and additional deceptive conduct of Ferrer and Ortiz render them directly liable as substantial participants in UBS PR's fraudulent scheme on investors. Third, the same acts, misrepresentations and omissions aided and abetted UBS PR's fraud.

## II. BACKGROUND

### *A. Respondents And Entities*

**UBS PR,** a Puerto Rico corporation with its principal place of business in Hato Rey, Puerto Rico, is a broker-dealer registered with the Commission since 1982. UBS PR is a subsidiary of UBS Financial Services, Inc., ("UBS"), a New Jersey and New York-based broker-dealer registered with the Commission. UBS PR is the largest broker-dealer in Puerto Rico with about 49 percent of total retail brokerage assets, employing about 230 registered representatives ("financial advisors") and maintaining 26 branch offices.

**UBS Trust Company of Puerto Rico ("UBS Trust Company")** is an unregistered entity that shares offices and personnel with UBS PR, and serves as the investment adviser, administrator, transfer agent and custodian for the CEFs.

**UBS Puerto Rico Closed-End Fund Companies.** Since 1995, UBS PR has served as the primary underwriter for 14 CEFs it alone manages, with a total of more than $4 billion in market capitalization as of September 30, 2009. In addition, the firm has co-managed with Popular Securities, Inc. nine additional CEFs with more than $1 billion in market capitalization as of September 30, 2009.[1] The CEFs predominantly hold Puerto Rico municipal bonds and are only available to Puerto Rico residents. The CEFs are not traded on any exchange or quoted on any quotation service. UBS has been the only secondary market dealer or liquidity provider for the sole-managed funds and the dominant dealer for the co-managed CEFs, effectively

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[1] UBS Trust Company serves as the sole manager for: Puerto Rico Fixed Income Funds I – VI; Puerto Rico Mortgage Backed & US Govt. Fund; Tax-Free Puerto Rico Funds I and II; Tax-Free Puerto Rico Target Maturity Fund; Puerto Rico AAA Portfolio Target Maturity Fund; Puerto Rico AAA Portfolio Bond Funds I and II; and Puerto Rico GNMA & U.S. Gov. Target Maturity Fund. Popular Securities serves as co-manager with UBS Trust Company for Puerto Rico Investor's Tax-Free Funds I – VI and three other funds, but trading by Popular Securities represented at most five to ten percent of the trading activity in the co-managed CEFs.

controlling the secondary market for all CEFs. During the relevant time period, the same group of UBS executives, headed by Ferrer, controlled the CEFs' broker-dealer and principal underwriter (UBS PR), the CEFs' asset manager (UBS Trust Company) and all 23 CEF companies.

**Ferrer**, 74, was UBS PR's Chairman and CEO from 2003 until October 2009, when UBS PR temporarily terminated him. The firm re-hired him three months later as Vice Chairman. Ferrer was also CEO of UBS Trust Company and served as Chairman of the 23 CEF companies during the relevant 2008-09 time period. Ferrer held Series 1, 4, 5, 40, and 65 securities licenses during that period. In 2008, UBS PR paid Ferrer a total of $2,583,400, which consisted of, among other things, $300,000 in salary and the rest in incentive payments. In 2009, he received $2 million in compensation, $1.7 million of which was incentive payments.

**Ortiz**, 52, has served as UBS PR's Managing Director of Capital Markets and been in charge of the firm's trading desks since 2003. He had limited experience with closed end funds and pricing securities prior to joining UBS PR as head of the trading desk. At UBS PR, he has supervised and been heavily involved in trading, as well as involved in valuing the underlying securities that make up the Funds, and structuring new primary offerings of Funds. During the relevant period, he spent 60 to 70 percent of his time overseeing the CEF secondary trading market. He held Series 7, 24, 53 and 55 securities licenses during the relevant time period. In 2008, Ortiz was paid $1,063,200 (of which $225,000 was salary) and the rest was bonus or incentive payments. The following year, he received $1,153,000, with incentives comprising $928,000 of that amount.

### *B. The Closed End Funds*

UBS PR began offering CEFs to its customers in 1995. The 23 Funds represent the largest single source of revenue for the firm. For example, in 2008, the Funds generated approximately $178 million in revenue, or 53 percent of the total annual revenue for UBS PR and UBS Trust Company combined. The money came from various sources, including Fund advisory, administration and management fees and sales commissions. UBS PR's financial advisors, who heavily marketed the Funds, earned up to a 3.5 percent commission on Fund sales, and the trading desk also earned up to five cents per share traded. Ferrer once referred to the asset management fees UBS PR earned as the firm's "powerful profits driver."

Investors in the Funds could purchase them either in a primary, initial offering when UBS PR introduced a new Fund, or in the secondary market from other investors or UBS PR's inventory account. Ortiz headed up the trading desk that was responsible for all trading in the CEF secondary market. Because UBS PR introduced only two new Funds in 2008 and 2009, the vast majority of customer purchases and sales in that period occurred in the secondary market.

The majority of investors in the CEFs were elderly and had little prior investment experience. Many were retirees who were looking for safe investments to protect their retirement nest egg and for investments that could produce income on which they could live. As a result, investors were extremely sensitive to share price changes in the Funds, fearing a drop in prices could lead to losses they could ill afford. The testimony at the hearing will show Ortiz and those who assisted him in trading and pricing the CEFs knew investors were price sensitive, and this significantly affected their pricing decisions.

The testimony from several investors and financial advisors at the hearing will show financial advisors heavily marketed the Funds, touting their safety and consistent returns. Specifically, investors will testify financial advisors told them their principal would be protected, UBS PR "backed" the CEFs, they could sell their Fund shares quickly any time they needed to, and the CEFs would generate annual returns of six to eight percent. Investors will further testify financial advisors did not advise them of specific and unique risks associated with the Funds – UBS PR's trading desk was the sole liquidity provider for Fund trading, UBS PR could decide at any time not to maintain a market for Fund trading, and there were frequently waits to sell shares – especially in 2009 when UBS PR lowered prices and impeded customer sales. As discussed in more detail below, UBS PR, Ferrer, and Ortiz did not advise financial advisors or investors in 2009 the firm had stopped maintaining a market altogether. There will also be testimony from financial advisors that they did not discuss these risks with potential investors.

UBS PR also provided little written information to investors in the secondary market. Each Fund had a prospectus, but the firm did not regularly provide prospectuses to secondary market purchasers. Beginning in January 2008, UBS PR developed a marketing pamphlet entitled the Family of Funds Brochure. While the Brochure was posted on UBS PR's website, the firm did not require its financial advisors to provide it to customers, and we expect the testimony from financial advisors and investors to show the financial advisors routinely did not give the Brochure to investors. Furthermore, in 2008 and 2009 the Brochure was posted only in English, and many investors spoke primarily Spanish and could not read English. Finally, as discussed in more detail below, both the Brochure and prospectuses provided to investors in two 2008 primary offerings contained misrepresentations about CEF pricing and trading.

### *C. Fund Pricing*

There will be a great deal of testimony about the CEF share prices at the hearing, and an understanding of how UBS PR priced the Funds is crucial to understanding how the firm, Ortiz, and Ferrer repeatedly misled customers. The first important fact to understand is the CEFs issued shares at their Net Asset Value ("NAV"). NAVs are simply the prices at which the underlying Fund holdings, such as various Puerto Rican governmental agency municipal bonds or preferred stocks, were valued. As our expert witness, Dr. Edward O'Neal, has indicated in his report, the majority of closed end funds trade for a variety of reasons at a discount to NAV. However, the 23 CEFs in this case traded at significant premiums to NAV – that is, the share prices UBS PR set and published were higher than the Fund NAVs.

Our expert has determined that, unlike many other closed end funds, UBS PR's prices did not correlate to the movement of the Funds' NAVs. This pattern was responsible for much of the concern of UBS' senior executives in 2009 about UBS PR's increasing inventory, and played an important role in UBS' decision to order the 2009 inventory reduction.

Furthermore, the difference between share and NAV prices was responsible for what top UBS PR executives termed "the number one selling point of the CEFs" – UBS PR's undocumented dividend reinvestment share program. The prospectuses indicated investors could elect to get their dividends either in cash or by receiving additional CEF shares (known as dividend reinvestment shares) issued at NAV. What no written materials discussed, however, but what financial advisors heavily marketed, was that investors could immediately sell their dividend reinvestment shares at UBS PR's published prices. Thus, at times during 2008 and 2009, with share prices running significantly higher than NAVs, investors could sell their dividend reinvestment shares at immediate profits of up to 45 percent – far more than they could expect to receive through a cash dividend payment.

For seniors who depended on their monthly dividend checks for living expenses to supplement Social Security and other retirement payments, this word-of-mouth program was immensely popular. It also exacerbated the selling pressure on the Funds in 2008 and 2009, which was already high. And the popularity of the program only increased pressure on UBS PR's trading desk to keep share prices high so the monthly reinvestment sales stayed profitable.

Because UBS PR was the only broker-dealer that traded the CEFs, and because the Funds were not quoted or exchange-traded, determining CEF share prices was solely within the purview of UBS PR. And within UBS PR, Ortiz had the final word on all pricing decisions. For most of the relevant period in this case, UBS PR's written pricing procedures were limited to a single paragraph in a 12-page document adopted in May 2007 entitled "UBS Puerto Rico Secondary Market Order Handling and Trading Guidelines Closed End Funds." It stated:

> In considering whether the Firm's pricing complies with its best execution obligations, Capital Markets Management shall consider its internal pricing model (that bases prices on current yield formulas or yields to estimated maturity dates, depending on whether the Fund is a perpetual fund or a target fund), absolute yield levels in comparison to other market instruments, relative yields of the Firm's Funds compared to other Firm Funds, as well as supply and demand conditions. Lesser emphasis, and at times no consideration, may be given to prices of funds managed or traded by competitors.

In reality, the entire pricing process was left to the discretion of Ortiz and Carlos Rosado, the CEF head trader who reported directly to Ortiz. Ortiz has identified a number of factors he allegedly considered in pricing the Funds, and has maintained that overall supply and demand was the primary factor. But other, more objective evidence shows supply and demand had little to do with CEF pricing – in contrast to UBS PR's representations to the investing public. For example:

- Ortiz has been unable to state how any particular factor affected prices at any given time.
- Ortiz furthermore has never been able to give a single concrete example of how supply and demand influenced a pricing decision.
- Rosado testified that keeping yields of the Funds consistent was the primary factor in considering prices in 2008. CEF prices move inversely to yields; that is, the higher the share price the lower the yield and vice versa. Rosado testified that even in situations where a Fund price was high and there were more investors trying to sell a Fund than buy it, he would not necessarily lower the Fund price to attract buyers if that would increase

the Fund yield too much over yields of other comparable Funds. The fear was the resulting yield "imbalance" would cause investors to sell other Funds with lower yields, thereby causing more selling. Thus, the desk did not set prices in response to market forces such as supply and demand, but in response to its desire to keep yields stable and consistent so as to attract investors.

- Numerous emails in 2008 and 2009 from Ortiz, Ferrer and others discussing Fund prices clearly state the primary factor in pricing them was their yields.

- Rosado and financial advisors will testify investors were price sensitive, and dropping prices would be just as likely to cause a selling panic among investors (fearing that Fund prices were dropping and they would lose money) as cause them to buy Funds at lower prices. This was another reason having nothing to do with supply and demand why the trading desk kept prices high.

- Rosado will testify the primary factor in setting Fund prices during the 2009 inventory dump was ensuring they were lower than customer orders so UBS could sell its inventory ahead of customers.

Numerous UBS PR internal pricing sheets, emails, and other documents provide additional evidence that UBS PR's primary pricing goal was to provide stable CEF share prices and yields. Internal communications between Rosado and Ortiz discuss achieving "price stability," and finding prices to "reduce volatility." They also discuss how "the PR market [is] not used to high price volatility." In short, there was no verifiable pricing methodology subject to any meaningful supervision.[2]

*D. Indicative Bids*

Each day, and sometimes more frequently, Rosado emailed an inventory sheet to all financial advisors. Among other things, these inventory sheets contained prices for each Fund at which UBS PR's trading desk would buy shares from investors selling them ("bid") or, conversely, prices for each Fund at which the trading desk would sell its inventory of shares to

[2] UBS PR's Compliance Department did not audit or test CEF pricing. The Deputy Chief Compliance Officer, who had supervisory responsibility over the trading desk, never questioned the CEF pricing process because, "[t]he methodology – pricing of the closed-end fund shares is not a mathematical equation nor is it a science. It is an art form."

investors interested in buying ("offer"). The inventory sheets also contained the number of shares the trading desk would buy or sell at a particular price.

Unbeknownst to investors, the trading desk had a policy of sometimes posting what it called an "indicative bid" on the inventory sheets. This type of bid, noted as the number "1" on the inventory sheets, meant the desk was not actually offering to buy *any* investor shares. Rather, an indicative bid was the trading desk's best estimate as to what price it would pay to buy shares if it were interested in doing so. In reality, an indicative bid meant the desk was not in the market to buy investor shares.

Beginning in May 2008, and occurring with increasing frequency throughout 2008 and 2009, the trading desk sent inventory sheets to financial advisors containing indicative bids. In fact, between late January and early August 2009, the desk sent *only* indicative bids for all 23 Funds to financial advisors. This meant for at least six months, the trading desk did not commit to buy a single CEF share from investors, regardless of what the Fund price was or how many investors were interested in selling at those indicative bid prices.

During this time, Ferrer and Ortiz knew the Family of Funds Brochure and the 2008 prospectuses contained the false statement that while UBS PR "currently intends to maintain a market in the [CEF] shares, and has since 1995, it is under no obligation to do so." In fact, the firm and its trading desk had *stopped* maintaining a market for the Funds by refusing to publish firm bids to buy shares and lowering prices to prevent customers from selling their shares. Their actions also rendered false the statements in the Brochure and 2008 prospectuses that the CEFs "market price" was based on supply and demand in a competitive market. As just described, there were no true CEF market prices during this period, only the trading desk's estimates and prices based on factors having nothing to do with supply and demand.

Although the inventory sheets contained language indicating financial advisors should ensure investors knew UBS PR was not agreeing to buy at these prices, there is no evidence financial advisors communicated this to investors, or that the trading desk or anyone at UBS PR followed up to ensure customers were aware there was no actual demand for the shares they wanted to sell.

This trading desk posture of only sending out "indicative" prices was in stark contrast to information Ortiz and the trading desk put out to the investing public. For example, UBS PR regularly published CEF prices, NAVs and yields in *El Vocero*, Puerto Rico's second largest daily newspaper. The newspaper obtained the prices and other quotes from UBS PR's trading desk, a process Ortiz supervised. Although the newspaper published the price quotations under a heading that simply stated "prices," in reality, they were not really prices at all. In most cases, the published quotes represented share prices plus three percent sales commissions, a fact never disclosed to investors.

Furthermore, on many days the prices represented only the desk's indicative bids, not actual prices at which UBS PR was buying and selling Fund shares. This fact was also nowhere to be found in *El Vocero*. Finally, on numerous occasions in 2009, the published prices were often higher than those on the trading desk's internal inventory sheets, meaning investors reading the newspaper were deceived into believing UBS PR was buying shares at prices higher than it actually was. While UBS' price transmission e-mails to the newspaper explained the prices were "for informational purposes only," that advisory was not printed anywhere in newspaper. Nor is there any evidence, after years of paying *El Vocero* to publish CEF prices, UBS PR ever insisted the newspaper include that advisory line or any other information explaining the quoted "prices" were not true market prices at all.

In fact, in further contrast to the claims that supply and demand determined CEF prices, UBS PR's internal order records show that on many days throughout 2009, there were significant numbers of customer orders to sell Fund shares at or below the "prices" UBS PR transmitted to *El Vocero*. Yet UBS PR did not execute those orders, on many occasions because it had already dropped its indicative bid levels by the time the so-called prices appeared in the newspaper so it could sell its inventory ahead of customer orders.

Additional evidence of UBS PR's deception of customers appears on their monthly and quarterly account statements. Each month the trading desk, under Ortiz's supervision, transmitted the price quotes to UBS, which listed them as CEF "Market Values" in account statements it sent to investors. These statements were also similarly devoid of any disclosure that the CEF prices reflected were frequently indicative bids, rather than true values of the funds based on market prices. Even UBS PR's Chief Deputy Compliance Officer has acknowledged the account statements in 2008 and 2009 did not adequately explain how share prices and Fund values were computed for purposes of the statements.

## III. THE 2008-09 PRICE AND LIQUIDITY CRISIS

### *A. Inventory Increases As Investors Try To Sell, But Prices Remain Constant*

By no later than May 2008, Ortiz knew there was a "supply and demand" imbalance in the CEF secondary trading market he supervised. In other words, there were far more investors trying to sell shares than buy them. The testimony will show a number of factors were responsible for this problem, including failing global financial markets, drastically falling stock prices, and the Puerto Rican government fiscal crisis. The combination of these factors was causing jittery investors to try to get rid of some or all of their CEF holdings, which largely contained Puerto Rican government bonds.

In late April, Ortiz requested an increase in UBS PR's historical CEF inventory limit of $30 million (which UBS set and which UBS PR needed parent company permission to exceed) to $40 million. Concerned parent company executives questioned Ortiz on why he needed an inventory limit increase. Among other things, he told them that "given market conditions, we do not want to decrease prices of the funds." UBS executives agreed to the $40 million limit through May only. Yet just two weeks later, Rosado emailed Ortiz and his supervisor – Eugenio Belaval – that CEF inventory was continuing to grow. It was now up to $37 million, and the firm had $10 million in "marketable" orders that it needed to execute (meaning customers were offering to sell shares at or below the price at which UBS PR was offering to buy them). Impressing the urgency of the situation on his bosses, Rosado asked to discuss the situation at their earliest convenience.

The following day, May 16, Ortiz notified Belaval and his supervisor, Carlos Ubinas, about the growing CEF market imbalance, where Fund sellers greatly exceeded buyers. Ortiz acknowledged the trading desk either had to execute these customer orders, and thereby take $10 million into inventory (putting Fund inventory at $47 million, above even the temporary limit of $40 million), "or change the [bid] price of the funds" to below the prices at which the customers wanted to sell.

Although Ortiz discussed dropping Fund prices, the overwhelming evidence shows that over the next several months, Ortiz (with Ferrer's knowledge and approval) did everything possible to avoid reducing CEF share prices. In email after email with Rosado, Ferrer, Belaval, Ubinas and parent company executives, Ortiz continuously acknowledged the scope of the problem. For example, in June, Rosado and Ortiz discussed the high inventory in certain Funds and the need to address the problem. In October, Rosado and Ortiz exchanged emails about an inventory level of more than $44 million, an increasing number of sell orders, and the need to reprice and "stabilize the market." In a November email with a sales manager, Ortiz discussed the high number of sell orders. In December, Rosado emailed Ortiz about increasing pressure from financial advisors to sell Funds. In January 2009, Ortiz emailed Ferrer and Belaval about the continuing "imbalance" between sell and buy orders and the need to reduce prices.[3]

In many of these emails, Rosado and Ortiz discussed the fact that investors looking to sell dividend reinvestment shares were exacerbating the problem by increasing the number of sell orders in an increasingly illiquid market. They debated what to do about the problem, as complaints from customers who had come to depend on the monthly sales for income escalated, and financial advisors continue to pressure the desk on behalf of their clients to execute these sales. Ortiz and Ferrer in the spring of 2009 complained dividend reinvestment sales were "locking up the market" and hindering other investors from selling.

Yet despite acknowledging the scope of the problem, Ortiz refused to reduce prices to attract more buyers. Almost every month from June through December 2008, Ortiz directed Rosado to request either inventory limit increases or continuations of prior increases to keep CEF inventory well above the historical $30 million limit. Inventory levels rose as high as $50 million in December 2008 and January 2009. At the same time, Ortiz was trying to increase demand for certain Funds without dropping prices. For example, in June 2008, he told Rosado to develop "sales stories" for certain Funds with high inventory limits. He also agreed to reduce the five-cent sales charge the trading desk normally charged to facilitate buying. In January 2009, he approved Rosado telling financial advisors to "resolve the market imbalance" by placing place buy orders at "a price that you consider an opportunity for your clients."

[3] Dr. O'Neal's quantitative analysis confirms what Ortiz and others knew – investors were increasing efforts to sell their Fund holdings in 2008. In his Rebuttal Report, Dr. O'Neal indicates that customer sell orders increased after May 2008.

During this time CEF share prices remained constant. Ortiz did not change prices for nine Funds on any trading day from May through August 2008, while only changing prices for other Funds on five trading days or less. For example, the Trading Desk quoted $9.65 per share for every trading day for the PR Fixed Income Fund I (a $460 million fund), even with $5.7 million shares of that Fund in inventory and a declining NAV. In fact, from May through December, Ortiz only once changed the price of that Fund.

Ortiz ensured other CEFs saw similarly unchanging prices during 2008. On every trading day from May until August 2008, UBS PR's trading desk quoted the same $9.90 per-share price for the PR Investors Tax Free Fund I, and only changed the price of that Fund on three trading days through December 2008, even with inventory rising to $3 million. Yet even after Rosado suggested to Ortiz they should "be more active in daily pricing to reflect daily changes in supply and demand" to "create a more active market," they continued re-pricing the CEFs on a very limited basis.

As Dr. O'Neal discusses extensively in his report, these constant prices were highly aberrational, especially in light of the fact that the majority of the Funds NAVs were declining. Dr. O'Neal compared the CEF prices to NAVs with a control group during: (1) the almost three years before May 2008; (2) May 2008 through February 2009; and (3) March through September 2009. Dr. O'Neal found that while the correlation between price and NAV levels were similarly high for both the control group and the CEFs between October 2005 and May 2008, things changed after May 2008. Between May 2008 and February 2009, there was still a strong correlation between prices and NAVs in the control group, but not so for the CEFs. There, the correlation between price and NAV levels broke down. Prices stayed the same, while NAVs were dropping. The reason: Ortiz did not want to drop prices for the Funds. Rosado explained why Ortiz wanted higher CEF prices:

> "When you have higher prices, everybody starts saying, okay, the prices are going up. So everybody is calm . . . like everybody says, it's happy. So that's what he's trying to achieve here, higher prices," so "everybody starts talking good about the funds."

Starting in November 2008, UBS exceeded its inventory limits for certain CEFs, yet Ortiz still did not change prices of those funds. In mid-December 2008, Ortiz and Rosado caused UBS to exceed its total $50 million CEF inventory limit in order to process customers' dividend reinvestment sales. Rosado assured UBS' Risk Officer the Trading Desk would "revise prices tomorrow to bring the inventory down to the 50MM limit." Rosado has testified there were no other market factors behind the decision to start lowering CEF prices other than to reduce the value of UBS' inventory holdings under the limit.

*B. Ferrer Pushes Fund Sales Without Disclosing The Illiquidity Crisis*

Ferrer was concerned about the increasing illiquidity crisis throughout 2008. His response was to push Ortiz and the firm's financial advisors to increase sales without disclosing UBS PR was propping up Fund prices or existing CEF holders could increasingly not sell their shares. On August 12, 2008, UBS PR's Group Management Board, including Ferrer and Ortiz, met. Among other things, the board discussed the "market drag," "product fatigue," and "weak secondary market" for CEF shares. Ferrer acknowledged financial advisors were growing increasingly uneasy about promoting the Funds.

Just 17 days later, Ferrer wrote to UBS PR executives that "[i]t is clear to me that we have to fix this. . . ." He directed them to "generate a story for each Fund," that financial advisors could use to increase sales and work with the traders to coordinate bids and offers. Around the same time, he directed Ortiz's Capital Markets Group to help increase demand for the Funds, in part by creating a "Wholesaler" and "Facilitator" to assist with selling the Funds with the highest inventory. Ferrer stressed the need to quickly solve the liquidity crisis because he feared "apathy in the Funds."

Still later, in December 2008 and January 2009 when financial advisors began to complain more vociferously about selling problems and one FA even accused the trading desk of "manipulating" CEF prices, Ferrer instructed Ortiz to meet with the financial advisors to provide "appropriate justifications" and make them "believe" in the Funds.

Thus, Ferrer understood a perfect storm was about to hit the Funds. He knew Fund holders were trying to sell their shares in increasing numbers, Fund buyers were scarce, and the only thing keeping prices from dropping was UBS PR's decision to take shares into inventory. He further knew that because of UBS' inventory limits, the trading desk would soon run out of ability to buy Funds into inventory, and, if UBS PR did not find buyers soon, it could not keep prices high. Yet Ferrer's communications with financial advisors in the fall of 2008 told a completely different story.

For example, in a September 18, 2008, email, Ferrer told financial advisors "[i]n the midst of all the turmoil, I note the <u>superior performance of our local funds.</u>" On September 29, 2008, he told financial advisors in an email that "our Funds are doing fine and are clients are not suffering unduly…transmit confidence and calm and pursue opportunities." The next day, he wrote to financial advisors that the Funds' low volatility was "a <u>great</u> reason to consider them as a timely investment. Plus their returns are superior!" Ferrer failed to mention the *only* reason for the Funds' "low volatility" and superior returns was UBS PR's artificial propping up of prices.

On October 9, 2008, Ferrer exhorted financial advisors to "keep in mind that local investors have side stepped the wrath of the marketplace and have been enjoying superior returns from our Funds." In none of these communications did Ferrer reveal the truth about the CEFs' illiquidity problems and pricing decisions. As a result, financial advisors continued to inadvertently deceive customers when they offered and sold Funds to them without informing them of the illiquidity problems and pricing issues.

*C. Two New CEF Offerings At The Height Of The Liquidity Crisis*

A key reason Ferrer pushed Ortiz and the trading desk to maintain high, stable prices, and then touted the performance of the CEFs to the financial advisors, was to pave the way for two new CEF primary offerings in the fall of 2008 totaling $66 million – Puerto Rico Fixed Income Fund VI, Inc. and Puerto Rico AAA Portfolio Bond Fund II, Inc. UBS PR served as underwriter, while Ferrer simultaneously served as the Chairman of: (1) the underwriter; (2) each of the new CEF companies; and (3) the CEFs' investment adviser (UBS Trust Company). Primary offerings of new CEFs not only benefited UBS PR because of management, underwriting and sales fees, but also Ferrer personally because his compensation was based on revenue performance of the UBS PR companies.

At the same UBS PR Group Management Board meeting on August 12 where executives discussed the weak CEF trading market, Ferrer, Ortiz and other UBS PR and UBS Trust Company executives discussed their objective to launch five new CEFs by 2012 and grow assets under management at a rate of $1 billion per year. As discussed above, Ferrer recognized the illiquidity of the CEF secondary market hindered new offerings and told UBS executives "[i]t is clear to me that we have to 'fix' this…." He ordered them to do so by increasing demand through UBS PR's sales force and facilitating large cross trades between customers. Ferrer also proposed that the trading desk stand ready to bid at least $100,000 in each Fund at any time. Ferrer warned Ortiz: "I think we all need to remember that if there are no sales, there can be no purchases and no need for a trading desk . . . we need to immediately solve what has certainly become our most criticized function and one which could result in apathy for the Funds."

Days later, Ferrer privately told Ortiz and other executives he was directing UBS PR's Investment Banking department to move forward with the primary offerings regardless of the high CEF inventory holdings, stating: "I want these [two primary offerings] to happen right away. I do not want to keep postponing new availability for reasons of inventory, no way!" Around the same time, when one financial advisor questioned why UBS PR was offering new Funds when the existing market was saturated, Ferrer responded "because it's good for clients." Earlier, he had sent an e-mail to all financial advisors in which he sought to downplay any secondary market problems:

> Others were concerned, because of their worry secondary market activity would be reduced and prices affected in old Funds. Not to worry!!! No one should feel discomfort for our opening new Fund opportunities; because the local marketplace [is] in a very rapid consolidation . . . We have put in place a growth strategy in a consolidating market! It is bold, but it is right. This move should have little direct effect on secondary market activity, and if any, a positive one.

At Ferrer's direction, UBS PR's Investment Banking department also made a presentation to financial advisors in connection with the new CEF offerings. The presentation stated customers should invest in the new Funds because, among other things, "[f]und inventory levels are low, trading volumes are at all time high (annualized), and prices/yields are aligned with current market conditions." These statements were patently false.

In numerous communications with financial advisors in the two weeks prior to the primary offerings, Ferrer stated in part:

- In the midst of all the turmoil [the global financial crisis], I note the superior performance of our local funds. They seem to be weathering the "Wall Street Storm"... you should look at these for clients searching for low volatility and respectable returns.

- Financial Advisors: There is a certain comfort in owning our Funds; low volatility, attractive returns (in fact very attractive). Conclusion: Worth Considering!!! Look at Fund VI...; it will presently provide good yields.

- 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.

- [T]he 'Bailout' has shaken the markets across the World... The good news is our Funds are doing fine and our clients are not suffering unduly.

- Financial Advisors: Did you note 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?

As discussed above, these false and misleading statements resulted in the offer and sale of Funds to investors who did not know the truth about the CEFs.

During September 2008, Ortiz also helped conceal UBS PR's dire CEF inventory situation from financial advisors by directing Rosado to alter the daily CEF inventory sheets he sent them showing the amount of shares in inventory in each Fund. For the entire month leading up to the new CEF primary offerings, the inventory sheets were changed to reflect a maximum of first 25,000, then 50,000 shares per Fund, rather than the actual shares in inventory. But a separate internal sheet at that time only the trading desk had access to showed the actual inventory in each Fund.[4] For example, the inventory sheet and the GTC book on September 3, 2008 show the following:

| Fund | Inventory Sheet Shares Shown | Actual Inventory Shares |
|---|---|---|
| Tax Free P.R. Fund I | 25,000 | 560,522 |
| Tax Free P.R. Fund II | 25,000 | 280,479 |
| P.R. Fixed Income Fund V | 25,000 | 225,154 |
| PRTIFF III | 25,000 | 312,579 |

[4] This internal sheet was known as the Funds Intraday Inventory Sheet. It was also known as the Good Til Canceled ("GTC") Order Book, because the trading desk placed limit orders it did not execute in the book. The trading desk began circulating the GTC Book on a daily basis to financial advisors only in March 2009.

| | | |
|---|---|---|
| PRTFF IV | 25,000 | 162,998 |
| PRTFF V | 25,000 | 224,287 |
| PRTFF VI | 25,000 | 258,124 |

Other days have similar discrepancies between what was actually in inventory and what the trading desk told financial advisors. Thus, Ortiz also ensured financial advisors did not know the extent of the illiquidity problems as they offered and sold the Funds.

On September 30, 2008, UBS conducted the first round of the primary offerings totaling $33 million, yet did not tell customers it had $40 million of secondary market CEFs in inventory at cheaper prices and without the 4.5 percent sales loads. Moreover, that same day, Ortiz and Rosado sent a trading desk inventory sheet to financial advisors showing only $8 million in inventory (in contrast to the actual $40 million). UBS PR made subsequent primary offerings to investors in these new CEFs at the end of October, November and December 2008, also without disclosing it had up to $50 million in inventory of other CEFs at lower prices. Internal UBS documents show there were no differences between the investment objectives, expected holdings or policies of the new CEFs and their predecessors.

The prospectuses for both CEFs repeated the same general disclosures contained in prior ones:

> 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 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.

The prospectuses did not disclose any information about: the existing secondary market illiquidity problems; UBS PR's propping up of market prices; or the increasing numbers of customers in other CEFs trying to get rid of their holdings.

## IV. UBS PR DUMPS ITS CEF INVENTORY ON CUSTOMERS

In early 2009, UBS PR's high CEF inventory levels and significant price premiums over NAV raised serious concerns at the highest levels of UBS and its Executive and Risk Control Committees. James Price, former UBS Head of Wealth Management, headed up the committees' inquiries to UBS PR and, along with Chief Risk Officer Bernd Michel, formulated responses to the concerns. Minutes of meetings, e-mails and other evidence show the committees ultimately decided UBS did not have the "risk appetite" for such significant levels of CEF shares in inventory, and therefore ordered UBS PR to drastically reduce its inventory. Accordingly, from March through September 2009, UBS PR dumped millions of CEF shares on customers by, among other things, reducing share prices to undercut UBS customers' pending sell orders.

### *A. UBS Orders The Inventory Reduction*

In March 2009, Michel started raising concerns to the Executive Committee about UBS PR's CEF pricing methodology, market illiquidity, and increasing CEF inventory. On March 19, he rejected a request from the trading desk to increase its inventory limit to $55 million, and told Ortiz to begin reducing inventory levels to their historical limit of $30 million. While protesting the decision, UBS PR executives nevertheless indicated they would comply. For example, Ubinas wrote Price in an email that UBS PR would reduce inventory by increasing demand using its financial advisors. If that did not work, he explained, "the ultimate weapon is the aggressive use of pricing to bring balance back to the market."

However, even before the orders to reduce inventory to $30 million, Ortiz had undertaken his own "aggressive use of pricing" to reduce inventory. Beginning in early March, Ortiz directed Rosado to regularly wipe pending "marketable" limit orders[5] off the GTC book by reducing CEF prices pennies below pending customer sales orders. For example, on March 3, 2009, the trading desk sent its GTC book to financial advisors showing $16 million in unexecuted customer sell orders at or below the bid price – the price at which UBS PR indicated it would buy shares.[6] That day, Ortiz instructed Rosado to "prepare a pricing where we eliminate the marketable GTC [customer] orders . . . This is top priority." A few hours later, Rosado lowered market prices of all 23 Funds to one penny below the best customer orders, rendering $14 million of customer orders "non-marketable." The GTC book Ortiz and Rosado sent to financial advisors on March 4 reflected only $2 million of pending executable customer sales orders. This strategy enabled the trading desk to start selling inventory shares before customers' orders, since its prices were now lower. Ortiz and the trading desk continued using this practice for several more months to reduce inventory.

Even after ordering the inventory reduction, Michel had additional concerns about the CEF situation in Puerto Rico. He expressed his concern to the Executive Committee on March 30 about high prices in the face of so many sellers and so few buyers, and the significant "difference between NAV and the price quoted by the trading desk . . . in some cases over 40%." He alerted the committee that due to the fact the trading desk had already exceeded UBS' internal inventory limits, "there is a significant likelihood that clients wishing to sell the shares received through the dividend reinvestment program will be unable to do so."

[5] Financial advisors could place either market or limit sell orders. A market order calls for a sale at whatever price the market will pay at that moment, meaning the trading desk had to give it top priority. A limit order specifies a sale under certain conditions, i.e., no lower than a certain price, only a certain number of shares, or the order is good only for a certain amount of time. The trading desk put unexecuted limit orders good for more than a day on the GTC book until they were canceled or executed.

[6] However, these bids were "indicative," meaning UBS PR was not committing to buy a single share – a fact it never disclosed to customers.

As a result, the Executive Committee directed UBS' Risk Control Group and Compliance Department to "review the current pricing method for the NAV and market value for the Puerto Rico Mutual CEFs" and to "closely monitor the . . . pricing process" because "prices quoted by the trading desk may be too high or may not reflect the actual 'market' value." After conducting their review, on May 19, 2009, Price and Michel reported to UBS' Risk Control Committee the following conclusions:

- UBS PR lacked CEF pricing procedures and controls;
- UBS PR was the sole CEF liquidity provider; and
- UBS PR had to reduce its CEF inventory to limit its risk exposure and "promote more rational pricing and more clarity to clients . . .[so] prices transparently develop based on supply and demand."

As a result, the Risk Control Committee on May 29 ordered UBS PR to further reduce its CEF inventory to $12 million. Michel directed this occur by selling $1 million of CEF shares a week. UBS PR largely achieved this mandate by continuing to lower share prices to keep ahead of customer orders. In a June 9, 2009 email from Ortiz to senior executives at both UBS PR and UBS, Ortiz described the plan in these simple, blunt terms: "purchasing from clients the minimum amount of shares possible and lowering our price to keep ahead of any client open orders in terms of lowest offer price in the market." In a presentation to UBS' Executive Committee just a few weeks earlier, Ortiz described this strategy of lowering price and reducing inventory as "Objective: Soft Landing."

Ortiz and UBS PR's strategy of undercutting customer sell orders was extremely successful – for the firm. As Dr. O'Neal found, the share price of 22 of the 23 CEFs decreased from March to September of 2009, and the price decrease was larger for the Funds with higher inventories. Furthermore, UBS PR achieved the vast majority of its inventory reductions immediately after reducing prices in the Funds. As Dr. O'Neal found, UBS PR achieved 73 percent of its inventory reduction between March and September 2009 in the two-day period after each reduction in Fund prices.

Communications between UBS PR and senior UBS executives are replete with the dire consequences they understood Fund customers were suffering as a result of the forced inventory reduction. For example, Michel told Ortiz and others his concern that a sharp reduction of prices would cause a "panic." Ubinas was also concerned, stating that "such 'forced' adjustments to prices would likely create major market disruptions . . . I am concerned that this could have unintended consequences and snowball into a wave of sell orders." In July, a senior executive at UBS Trust Company made it clear the result of the dump was that "UBS stopped supporting a market that made us $93 million last year."

Ortiz and Ferrer also lamented the effects of the inventory reduction in internal correspondence. For example, Ortiz sent Michel an email on June 17, 2009 complaining about "price volatility" having increased dramatically and "frequent price declines." Just a few days earlier, Ferrer had emailed a financial advisor and Belaval that "buyers are needed" as "prices continue to fall." On June 22, Ferrer told Ubinas, Belaval, and Ortiz they needed to stress to Price the "crisis" that had resulted from the forced inventory reduction. That same day, Ortiz wrote to Michel that that the inventory reduction had made buying the dividend reinvestment shares from clients "the most pressing situation for our clients . . . who are expecting a check from us this month."

Ferrer was especially critical in communications with Price and Martin Hoekstra, UBS' CEO. On July 28, he complained to Price and Hoekstra the inventory reductions had "resulted in not insignificant losses to the Trading Desk." Ferrer's true motive in complaining was revealed in the ensuing sentences:

> Furthermore, the results have been lower trading, thus lower sales credit volume. So our on going revenues are affected and this will be reflected in our profit line.
>
> As disturbing is that the present relative lack of demand for our Funds in the secondary market carries forth to our inability to launch new Funds and thus we are affecting our non-compensable revenues growth from management fees. These have been a powerful profits driver.

When Price responded the decision to reduce inventory was made to bring prices more in line with NAV levels, Ferrer kept us his barrage, writing on July 30 that the results of the reduction had caused "huge losses to our clients and to our P&L." He went on to state "we have caused a dislocation in the market place. We have also caused that clients and Financial Advisors regard Funds with a new distrust and that has reduced demand." The next day, Ferrer sent Hoekstra an analysis from Ortiz showing UBS PR customers had lost $250 million in their CEF holdings from March through July 2009.

*B. UBS PR Aggressively Solicits CEF Sales During The Dump*

In direct contrast to the dismal picture he painted to UBS senior executives, Ferrer painted a rosy picture of the CEFs to financial advisors. Throughout the spring and summer of 2009, while he knew UBS PR was reducing inventory and prices and causing customers to lose money, he extolled the virtues of the Funds to financial advisors in an effort to push sales even harder.

For example, on March 17, 2009, Ferrer wrote financial advisors that "you will find substantial demand for our Funds from IRA investors. Very attractive choices. Start accumulating our Funds now. Do not be a Lemming, be a Lion!" Two weeks later, on April 1, he wrote the "Funds' story is a great story where the investors have enjoyed very attractive results. The opportunity to use these Funds for IRA investments is now a reality. Make your clients aware of this opportunity."

On April 24, 2009, *El Vocero* published an interview with Ferrer in which he publicly touted the strengths of the CEFs:

> "The local mutual funds have had an excellent return during all this process," explained Ferrer. But through all of this, many investors call [UBS] scared about the news of the drop in financial markets, "when the reality is that news doesn't have any relevance for the investor." In general, "the Puerto Rican investor that has their money invested in bonds and mutual funds has obtained fantastic results . . . The result of an investor in local mutual funds, that has been able to reinvest dividends, has been superior and in some cases comparable with the stock market Indices," said Ferrer, and he assured "this type of investment offers much less volatility and relative positive results."

That same day, in another e-mail to financial advisors, Ferrer repeated his claims the CEF investment represented a good value for customers:

> NAV only reflects the valuation the market awards to the various assets in the portfolio, something we do not control. What we do control is the results of our CEFs and the premiums awarded clearly spell out we create good value for our CEF shareholders. . . But, as long as we can maintain attractive returns, we should expect premiums over NAV to be there. You should relate this to your clients.

This email quickly drew the attention of the UBS compliance department, which within *minutes* of Ferrer sending this email wrote him "[t]he communications have to be balanced and all of the risk factors and other important factors *must be conveyed to clients…"* (emphasis added). At the compliance department's insistence, Ferrer later emailed financial advisors that "[i]nvesting 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."

Still, Ferrer continued to push financial advisors to increase Fund sales. On August 3, 2009, just four days after he told Hoekstra the inventory reduction was causing "huge" losses of $250 million to clients, Ferrer told financial advisors the Funds continued to pay good dividends and were good investments. Eight days after that, he wrote again to financial advisors about "attractive yields" available in the CEFs and it would be "hard to find" another instrument offering comparative returns.

Ferrer was not the only one touting the Funds during the inventory reduction. On March 31, 2009, the day after Michel warned the Executive Committee about a CEF market "supply and demand imbalance," Ortiz and UBS PR made material misrepresentations and omitted material facts to more than a thousand customers at an investor conference about the CEFs' superior returns and consistent levels of liquidity.

Prior to the conference, Ferrer urged financial advisors to "<u>call your clients</u>, [because] the information presented will offer comfort to holders of Puerto Rico bonds and Funds." On the morning of the conference, Ortiz told Ferrer and other executives the message to be presented to investors was "[t]he Puerto Rico secondary market for munis and closed-end funds has shown resiliency (high liquidity, stable price) during these times." At the conference Ortiz made a presentation on the CEF secondary trading market, specifically touting the CEFs. The slides of the presentation to investors depicted:

- "Liquidity," defined as "the degree to which an investment can easily be converted into cash."

- "[C]onsistent levels of closed-end fund trading activity in 2008;" and showing increasing levels of trading volume (without explaining that a significant portion of the trading volume represented UBS' own inventory purchases).

- "Price Stability" defined as the degree to which the market price of an investment remains constant over time." Ortiz presented a chart showing the CEFs having experienced "moderate price gains" of 2.3 percent compared to the Thomson US All Muni Closed-End Fund Index -12.7 percent during 2007 and 2008.

- "Market Returns" exceeding 9 percent, greatly outperforming other major market indices, Barclay's Fixed Income Funds, and "All Fixed Income" funds.

- Multiple references to the CEFs' "Market Value," and "Market Returns," explaining that "Closed-End Funds trade at market prices" and that "[t]he market price of the fund shares is based on relative demand and supply of the shares."

Immediately afterwards, Ferrer sent an e-mail to UBS' sales force stating:

> 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.

Also during the spring and summer of 2009, Ortiz and other UBS PR executives held sales meetings with financial advisors focusing on promoting CEF solicitations while blaming falling CEF prices on global economic conditions. They never mentioned the inventory dump or the fact that the trading desk was reducing prices to get ahead of its customers' sell orders. Thus, not only were customers unaware UBS PR was selling its inventory and withdrawing CEF pricing and liquidity support, financial advisors were also kept largely in the dark. Risk Committee communications highlighted this:

> Jamie Price informed the Committee about a concern raised by some Puerto Rico FAs [financial advisors] 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 toward the funds.

However, nobody at UBS PR or UBS informed financial advisors about the inventory reduction until late 2009, after the reduction was over.

### *C. Harm to CEF Investors*

When UBS PR ceased supporting the CEF secondary market while simultaneously selling its own shares, prices dropped. From March to September 2009, 22 of 23 CEFs experienced price declines. Furthermore, as Dr. O'Neal found, investors holding CEF shares lost more than $600 million off their accounts. As discussed above, even Ferrer recognized the reduction's significant impact on CEF prices. Furthermore, the number of customer limit orders that were unexecuted climbed to more than $72 million by the end of September.

## V. MEMORANDUM OF LAW

### *A. Material Misrepresentations and Omissions Of The Respondents*

The misrepresentations, omissions and fraudulent conduct of Ferrer and Ortiz violated Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act, and Rule 10b-5. Section 17(a) proscribes fraudulent conduct in the offer or sale of securities, and Section 10(b) and Rule 10b-5 proscribe fraudulent conduct in connection with the purchase or sale of securities. These provisions prohibit essentially the same type of conduct. *United States v. Naftalin*, 441 U.S. 768, 773 (1979); *SEC v. Unique Financial Concepts, Inc.,* 119 F. Supp. 2d 1332, 1339 (S.D. Fla. 1998), *aff'd*, 196 F.3d 1195 (11th Cir. 1999). To establish a violation, the Commission must show: (1) a misrepresentation or omission (2) that is material (3) made with scienter (4) in the offer of or in connection with the purchase or sale of a security. *SEC v. Chemical Trust*, 2000 WL 33231600 at *9 (S.D. Fla. Dec. 19, 2000); *SEC v. Hasho*, 784 F. Supp. 1059, 1106 (S.D.N.Y. 1992).[7] As a fifth element, we also must establish the use of interstate commerce, the mail, or a national securities exchange. *SEC v. Corporate Relations Group*, 2003 WL 25570113 at *7 (M.D. Fla. March 28, 2003).

#### (1) Misrepresentations And Omissions

From May 2008 through September 2009, both Ferrer and Ortiz made fraudulent statements and omissions regarding CEF market performance, liquidity, and pricing. Ortiz made

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[7] Scienter is only required to prove violations of Sections 10(b) and 17(a)(1). Violations of Sections 17(a)(2) and (3) of the Securities Act do not require a finding of scienter. *Aaron v. SEC*, 446 U.S. 680, 697 (1980). The Commission may establish violations of these sections by showing negligence. *SEC v. Hughes Capital Corp.*, 124 F.3d 449, 453-54 (3rd Cir. 1997). Because Ferrer and Ortiz demonstrated scienter, our discussion assumes that by establishing violations of Sections 10(b) and 17(a)(1), we have also demonstrated they had the requisite state of mind to violate Sections 17(a)(2) and (3).

misrepresentations and omissions to investors directly at the March 31, 2009 investor conference, when he touted the CEFs' superior performance in a presentation that included statements about the Funds':

- Consistent levels of liquidity, trading activity and increasing trading volume;
- "Market returns" that outperformed nearly all other CEF investments in the United States;
- Low volatility and risk compared to other CEFs, index funds, and major market indices; and
- "Market prices" determined by supply and demand.

However, the facts show at the time of the conference, Ortiz knew: (1) there were significantly more CEF investors trying to sell than buy Funds; (2) UBS had already ordered UBS PR to substantially reduce its inventory; (3) the only reason prices and trading volume had stayed high in 2008 was because UBS PR was taking significant numbers of investor shares into its inventory; and (4) the trading desk he supervised had already started lowering prices below executable customer sell orders so it could sell UBS PR's inventory ahead of customers' shares.

Thus, Ortiz's statements misrepresented the true state of the CEF market to investors and therefore violated Sections 17(a)(2) and 10(b) and Rule 10b-5(b). *SEC v. Morgan Keegan & Co.*, 678 F.3d 1233 (11th Cir. 2012) (brokers' misleading statements and failure to disclose the known liquidity risk of auction rate securities could have "been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available"); *In re Merrill Lynch Auction Rate Sec. Litig.*, 2011 WL 1330847 (S.D.N.Y Mar. 30, 2011) (concluding broker's disclosures about the safety and liquidity of auction rate securities it sold to customers were insufficient where defendants had exclusive access to supply and demand information and knew the ARS market was teetering, and where the increased risk of auction failure and the lack of ARS demand was uniquely within defendants' knowledge); *Defer LP v. Raymond James*

*Financial, Inc.*, 2010 WL 3452387 at *10 (S.D.N.Y. Sept. 2, 2010) (broker-dealer was under a duty to correct materially misleading statement about liquidity and disclose information to investors that the ARS market was liquid only due to routine intervention by brokers to ensure success of auctions).

Alternatively, Ortiz made material omissions about the CEFs when he spoke to investors because once a person undertakes to disclose material facts concerning a securities transaction, that person "must speak fully and truthfully, and provide complete and non-misleading information." *SEC v. Curshen*, 2010 WL 1444910 at *7 (10th Cir. April 13, 2010); citing *In re K-tel Int'l Sec. Litig.,* 300 F.3d 881, 898 (8th Cir. 2002); *see also First Virginia Bankshares v. Benson*, 559 F.2d 1307, 1313-14 (5th Cir. 1977) ("Silence or omission to state a fact, is proscribed . . . where the defendant has revealed some relevant, material information even though he had no duty (i.e., a defendant may not deal in half truths")). As in the auction rate securities cases, Ortiz failed when he communicated with investors to disclose the true state of the market.

Ferrer made misrepresentations and omissions directly to investors in the April 24, 2009 *El Vocero* interview. The newspaper quoted him as touting the Funds' excellent returns and "fantastic results." He also told investors "this type of investment offers much less volatility and relative positive results." At the time he made those statements, Ferrer knew the CEF secondary market had been illiquid for most of the prior year, that UBS PR had been maintaining artificially high prices, that UBS had ordered UBS PR to substantially reduce CEF inventory, and UBS PR was dropping Fund prices to sell ahead of customers. Plainly Ferrer's statements in the interview constituted material omissions in light of that knowledge and his duty to speak fully and truthfully. In addition, they were blatantly false.

Also during 2008 and 2009, Ortiz and Ferrer made numerous false statements and omissions to financial advisors. Ortiz made presentations to UBS PR's financial advisors about the Funds, in which he discussed the benefits of investing in the funds – high yields, long-term profits, and dividends – while not disclosing the truth about the then-existing state of the secondary trading market (constant illiquidity, UBS PR buying the vast majority of shares, UBS PR withdrawing its support of the market by only publishing indicative bids, and UBS PR lowering share prices below customer sell orders to sell its inventory first). Thus, as the cases above make clear, Ortiz made misrepresentations and omissions during these presentations.

We set forth in great detail Ferrer's false and misleading statements to financial advisors in 2008 and 2009 in Sections III(B), III(C), and IV(B). The emails and other communications Ferrer had with financial advisors repeatedly extolled the virtues of the Funds. For example, he wrote about the "superior performance of our local funds" on September 18, 2008. On September 30, he promoted the Funds' "low volatility." Other emails talked about "attractive returns," both historically and those to be expected in the future. Ferrer's 2009 emails in the midst of the inventory dump were equally false and misleading, describing the Funds as "attractive choices," claiming there was "substantial demand" for them, touting their "attractive results," and stating prices should stay high relative to NAV levels. As discussed above, Ferrer's April 24, 2009 "Creation of Value" email to financial advisors was so misleading that UBS' compliance department criticized him and insisted he send a disclaimer ensuring financial advisors were aware of and disclosed risks of investing to their customers.

Ferrer's: knowledge of the imbalance in the CEF secondary market, where sellers far outnumbered buyers; repeated statements internally that UBS PR needed to create demand to keep Fund prices high; and his understanding of the inventory dump and falling prices and how they were harming investors; show his statements to financial advisors were false and constituted material omissions.

Ferrer and Ortiz may both be directly liable for their false statements and omissions to financial advisors, notwithstanding the fact they did not make these statements directly to investors. The law is clear the Division may prove liability for false statements and failure to disclose material information even if the statements never reached a single investor. *SEC v. Czarnik*, No. 10 Civ. 745, 2010 WL 4860678 at *4 (S.D.N.Y. Nov. 29, 2010) ("The fact that Czarnik's statements were not disseminated directly to investors does not foreclose liability under section 10(b), Rule 10b-5 and section 17(a)"); *Naftalin*, 441 U.S. at 771-77 (upholding conviction for scheme to defraud brokers and finding nothing in Section 17(a) of the Securities Act requires fraud to be perpetrated on investors); *SEC v. Graham*, 222 F.3d 994, 1002-03 (D.C. Cir. 2000) (*Naftalin* holding foreclosed petitioner's argument that Section 10(b) of the Exchange Act required fraud to be perpetrated on actual or potential investor); *A.T. Brod & Co. v. Perlow*, 375 F.2d 393, 396 (2nd Cir. 1967) ("Neither § 10(b) nor Rule 10b-5, it appears, speaks in terms of limiting the nature of the violation to one involving fraud of 'investors'; nor is there any justification for reading such an additional requirement into the Act"); *In the Matter of Orlando Joseph Jett*, File No. 3-8919, Exchange Act Release No. 34-49366, 2004 WL 2809317 (Commission Opinion, March 5, 2004) (trader could be liable for violating Securities Act Section 17(a) and Exchange Act Section 10(b) for deceiving his brokerage firm about the nature of his trading, causing the firm huge losses).

In *Czarnik*, the complaint alleged the defendant drafted and provided bogus opinion letters to transfer agents, which in turn allowed the transfer agents to issue unregistered shares of stock to promoters. The promoters pumped up the stock price then dumped the shares on the investing public. 2010 WL 4860678 at *1. The complaint was clear the fraudulent statements Czarnik made were *only* in documents he provided to the transfer agents, and were not made directly available to the investing public. *Id.* at *4.

The defendant moved to dismiss because the Commission did not allege he made misrepresentations to or deceived investors. The District Court denied the motion, holding liability for fraud under Sections 10(b) and 17(a) does not require false statements directly to or fraudulent conduct aimed directly at investors. *Id.* at *4-5. The false statements to transfer agents were sufficient to state a claim, especially when the effect of those false statements was that the promoters dumped shares of stock on the investing public. *Id.*

Similarly, the Supreme Court in *Naftalin* upheld the District Court's conviction of the president of a broker-dealer for a short-selling scheme in which the defendant aimed his conduct solely at brokers. The Court reversed the Eighth Circuit's decision to set aside the conviction specifically on the grounds that the broker's fraud had not been committed on investors and harmed only other brokers. The Court specifically rejected the Eighth Circuit's holding that "the government must prove some impact of the scheme on an investor." 441 U.S. at 771.

Accordingly, under Supreme Court precedent, the Division may prove Ferrer and Ortiz liable for fraud under Sections 17(a) and 10(b) by proving they made misstatements or omissions to financial advisors. As in *Czarnik* and other cases, the false statements ultimately resulted in the deception of investors because UBS PR offered and sold them CEFs without disclosing material facts about them.

(2) *Janus Capital Group's* Holding Is Not Relevant Here

Both Ferrer and Ortiz have attempted to introduce the issue raised in *Janus Capital Group, Inc. v. First Derivatives Traders*, 131 S.Ct. 2296 (2011) into the case by claiming we are attempting to hold them liable for statements financial advisors repeated to investors. However, as we explained in a prior brief, they are wrong, because there is no issue as to who made the false and misleading statements we are alleging here. We are not seeking to hold Ferrer and Ortiz liable for the statements of financial advisors to investors, but for *their* statements to financial advisors (of course, as we discussed above, both also made false statements and material omissions directly to investors). Therefore, *Janus* does not affect the Respondents' responsibility for the misstatements the Division alleges in this case.

Furthermore, *Janus'* requirements regarding "making" a false statement only apply to affirmative misstatements under Rule 10b-5(b). *Janus* does not foreclose liability under that subsection based on material omissions. *Janus,* 131 S.Ct. 2296 (not discussing omissions and limiting holding to "material misstatements"). Nor does *Janus* foreclose scheme liability in violation of Rule 10b-5(a) and (c). Thus, a respondent who has not "made" a fraudulent statement cannot be held liable under Rule 10b-5(b) based on the statement, but that same respondent may be held liable for participating in a fraudulent scheme including that misstatement. *SEC v. Lucent Tech., Inc.,* 610 F. Supp. 2d 342, 361 (D.N.J. 2009); *In re Alstom SA,* 406 F. Supp. 2d 433, 475 (S.D.N.Y. 2005) (pre-*Janus* case concluding primary liability may arise out of the same set of facts under all three subsections of Rule 10b-5 "where the plaintiffs allege both that the defendants made misrepresentations in violations of Rule 10b–5(b), as well as that the defendants undertook a deceptive scheme or course of conduct that went beyond the misrepresentations").

Nor, as numerous courts have held, does *Janus* apply to the Division's claims under Section 17(a) of the Securities Act. *SEC v. Sells,* 2012 WL 3242551, at *7 (N.D. Cal. Aug. 10, 2012); *SEC v.* Stoker, 2012 WL 2017736, at *8 (S.D.N.Y. June 6, 2012); *SEC v. Sentinel*

*Management Group, Inc.*, 2012 WL 1079961, at *14-15 (N.D. Ill. Mar. 30, 2012); *SEC v. Pentagon Capital Management PLC,* 844 F. Supp. 2d 377, 422 (S.D.N.Y. 2012); *SEC v. Mercury Interactive, LLC*, 2011 WL 5871020, at *3 (N.D. Cal. Nov. 22, 2011); *SEC v. Geswein*, 2011 WL 4565861, at *2 (N.D. Ohio Sept. 29, 2011); *SEC v. Daifotis*, 2011 WL 3295139, at *5-6 (N.D. Cal. Aug. 1, 2011). For these reasons, *Janus* does not bear on the misstatements in this case.

<u>(3) The False Statements And Omissions Were Material</u>

A misrepresentation or omitted fact is material "if a reasonable investor would have viewed the misrepresentation or omission as 'having significantly altered the total mix of information made available.'" *Hoff v. Popular, Inc.,* 727 F. Supp. 2d 77, 88 (D. Puerto Rico 2010) (citing *Gross v. Summa Four, Inc.*, 93 F.3d 987, 992 (1st Cir. 1996), quoting *Basic Inc. v. Levinson*, 485 U.S. 224, 231-32 (1988)).

Here there is no doubt the false statements of Ortiz and Ferrer were material because they went to the heart of the reasons the CEFs were attractive investments (indeed the reason *any* investment would be considered attractive) – stable prices, consistently high yields, low volatility, and good and consistent dividend payments. Any reasonable investor would want to know before purchasing the CEFs that, in fact, UBS PR was the sole liquidity provider for Fund trading, that other investors could not sell their holdings, that UBS PR was keeping prices artificially high without disclosing an illiquid market, and, ultimately, the firm selling the Funds was at the same time lowering prices to undercut customer sell orders and look out first for its own financial interests. They also would want to know that in 2009, UBS PR had stopped entirely supporting the market.

(4) The "Bespeaks Caution" Doctrine is Not Applicable Here

The Respondents are likely to argue the "bespeaks caution" doctrine insulates them from liability because UBS PR's disclosures in the Family of Funds Brochure and the 2008 prospectuses render their false statements and omissions immaterial. However, they are wrong. The Brochure and the prospectuses disclosed that UBS PR intended to maintain a market in the Funds, but was not obligated to do so at any time. However, by 2009, UBS PR had, in fact, stopped maintaining a market in the Funds entirely. It had ceased entering firm bids to buy *any* CEF shares, and was lowering prices to sell its own shares ahead of customer shares.

Thus, there was more than a possibility UBS PR would not maintain a market in the Funds in 2009; the possibility had, in fact, come to pass. Under numerous cases, that renders "bespeaks caution" inapplicable. "Whether cautionary language may protect an issuer from liability for alleged misrepresentations in a stock offering, we have noted that "[c]autionary words about future risk cannot insulate from liability the failure to disclose that the risk has transpired." *Rombach v. Chang*, 355 F.3d 164, 173 (2nd Cir. 2004); *accord Slayton v. Am. Express Co.*, 604 F.3d 758, 770 (2nd Cir. 2010) ("[C]autionary language that is misleading in light of historical fact cannot be meaningful . . . ."). *See also Dolphin & Bradbury, Inc. v. SEC*, 512 F.3d 634, 640 (D.C. Cir. 2008) (highlighting "the critical distinction between disclosing the risk a future event *might* occur and disclosing actual knowledge the event *will* occur"); *In re Prudential Sec. Inc. Ltd. P'ships Litig.*, 930 F. Supp. 68, 72 (S.D.N.Y. 1996) ("The doctrine of bespeaks caution provides no protection to someone who warns his hiking companion to walk slowly because there might be a ditch ahead when he knows with near certainty that the Grand Canyon lies one foot away"); *Huddleston v. Herman MacLean*, 640 F.2d 534, 544 (5th Cir. 1981) ("[T]o warn that the untoward may occur when the event is contingent is prudent; to caution that it is only possible for the unfavorable events to happen when they have already occurred is deceit").

Accordingly, the Respondents' failure to disclose that UBS PR was undercutting customer sell orders and not entering firm bids to buy in 2009 was material.

<u>(5) Scienter</u>

Courts have defined scienter as a state of mind embracing intent to deceive, manipulate or defraud. *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 (1976). Numerous courts have concluded scienter may be established by a showing of knowing misconduct or severe recklessness. *SEC v. Carriba Air*, 681 F.2d 1318, 1322-24 (11th Cir. 1982). *See also In re Cabletron Sys., Inc.*, 311 F.3d 11, 38 (1st Cir. 2002); *Mississippi Public Employees' Retirement Sys. v. Boston Scientific Corp.,* 523 F.3d 75, 85 (1st Cir. 2008); *Greebel v. FTP Software*, 194 F.3d 185, 203 (1st Cir. 1999).

Both Ferrer and Ortiz engaged in knowing misconduct. As Chairman and CEO of UBS PR, Ferrer had full knowledge of the growing illiquidity of the CEF secondary market in 2008. As the emails cited above demonstrate, Ortiz regularly kept Ferrer abreast of trading desk developments, including the lack of demand for the Funds and the repeated requests for inventory increases. Nevertheless, Ferrer pressured financial advisors to aggressively sell the CEFs, telling financial advisors that CEF "market prices" would continue generating high returns for investors. Ferrer's knowledge of the harm the 2009 inventory dump caused investors is clear in his emails to Price and Hoekstra complaining about the problems. He estimated $250 million in investor losses at one point during the inventory reduction. Yet he continued to tell financial advisors to press ahead with sales without disclosing the truth about the Funds to them.

As the Head of Capital Markets at UBS PR, Ortiz had perhaps the greatest knowledge of the severity of the supply imbalance. Ortiz controlled CEF pricing decisions and, notwithstanding increasing evidence the CEFs were priced too high given the decreasing demand, he refused to lower prices and instead repeatedly requested increased inventory levels. He was aware of increasing complaints by the financial advisors about their inability to sell their customers' CEF shares. Ortiz approved the transmission of indicative prices (with three percent markups) to *El Vocero*. Ortiz also spoke at the 2009 investor conference, touting the outstanding performance and liquidity of the CEFs, without disclosing the inventory and price reductions. During that time, he held meetings with the sales force to falsely tell them that market forces were behind the decreases in CEF prices. He clearly displayed scienter.

(6) Remaining Elements

There can be little doubt the Division will show the remaining two elements: the misrepresentations and omissions occurred in connection with or in the offer of securities – the CEF shares were securities. Furthermore, Ferrer and Ortiz used email to communicate with other UBS PR and UBS executives. Investors and financial advisors used the telephone, wires and checks to consummate purchases of CEF shares; and investors received account statements in the mail, among other uses of interstate commerce. Accordingly, the Division will show at the hearing that Ferrer and Ortiz violated Sections 17(a)(2) and 10(b) and Rule 10b-5(b) by making material misstatements and omissions.

*B. The Fraudulent Scheme*

(1) Standards For Scheme Liability

Ferrer and Ortiz are also liable under Sections 17(a)(1) and (3) of the Securities Act and Rule 10b-5(a) and (c) of the Exchange Act for their substantial participation in a fraudulent scheme (along with UBS PR) that harmed investors. Exchange Act Rule 10b-5(a) and (c) make it unlawful to, in connection with the purchase or sale of securities, "employ any device, scheme, or artifice to defraud" or "engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person." Sections 17(a)(1) and (3) prohibit the same conduct in the offer or sale of securities. Courts have interpreted these provisions to create what is known as "scheme liability." *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148, 159 (2008); *United States v. Finnerty*, 533 F.3d 143, 148 (2nd Cir. 2008); *SEC v. U.S. Envtl., Inc.*, 155 F.3d 107, 111-12 (2nd Cir. 1998); *SEC v. First Jersey Sec., Inc.*, 101 F.3d 1450, 1471-72 (2nd Cir. 1996); *SEC v. Lee*, 720 F. Supp. 2d 305, 334 (S.D.N.Y. 2010); *In re Global Crossing, Ltd. Sec. Litig.*, 322 F. Supp. 2d 319, 336-37 (S.D.N.Y. 2004); *In re AOL Time Warner, Inc. Sec. and ERISA Litig.*, 381 F. Supp. 2d 192, 217, 229 (S.D.N.Y. 2004).

For the Division to prove a claim for a primary violation under Rule 10b-5(a) or (c), or Section 17(a)(3), it must show the Respondents: (1) committed a manipulative or deceptive act; (2) in furtherance of the alleged scheme to defraud; (3) with scienter.[8] *Alstom*, 406 F. Supp. 2d at 474-75; *Global Crossing*, 322 F. Supp. 2d at 336; *U.S. Envtl., Inc.*, 155 F.3d at 111. To be a basis for liability under Exchange Act Section 10(b) and Rule 10b-5, the deceptive acts must be carried out "in connection with the purchase or sale of any security." *Stoneridge*, 552 U.S. at 160.

A respondent violates Sections 17(a)(1) and (3) and 10(b) and Rule 10b-5(a) and (c) upon committing any manipulative or deceptive act that is part of a fraudulent or deceptive course of conduct, or is in furtherance of a scheme to defraud. *SEC v. Durgarian*, 477 F. Supp. 2d 342 (D. Mass 2007). A person is liable for a fraudulent scheme if he has "engaged in conduct that had

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[8] To prove a claim for a violation of Section 17(a)(3), the division need prove only that the respondent acted with negligence. Scienter is not required.

the principal purpose and effect of creating a false appearance of fact in furtherance of the scheme." *SEC v. Patel*, 2009 WL 3151143 at *9 (D.N.H. Sept. 30, 2009) (quoting *Simpson v. AOL Time Warner Inc.*, 452 F.3d 1040, 1048 (9th Cir. 2006)). The sections prohibit a wide range of manipulative and deceptive activities. *Santa Fe Indus. v. Green*, 430 U.S. 462, 477 (1977) ("No doubt Congress meant to prohibit the full range of ingenious devices that might be used to manipulate securities prices").

While claims for engaging in a fraudulent scheme and for making fraudulent statements or omissions are distinct claims, with distinct elements, a respondent defendant may be liable for all three sub-sections of Section 17(a) and Rule 10b-5 based on the same misrepresentations and omissions. Liability may arise out of the same set of facts where the Division, as we do here, alleges the respondents "undertook a deceptive scheme or course of conduct that went beyond the misrepresentations." *Alstom*, 406 F. Supp. 2d at 475; *SEC v. Pimco Advisors Fund Management LLC*, 341 F. Supp. 2d 454, 467 (S.D.N.Y. 2004) (scheme liability may exist where the fraudulent activity involved *some* conduct other than participation in a scheme to make a material misrepresentation); *WPP Luxembourg Gamma Three Sarl v. Spot Runner, Inc.*, 655 F.3d 1039, 1057 (9th Cir. 2011) (defendant may be liable as part of a fraudulent scheme "when the scheme encompasses conduct beyond misrepresentations or omissions").

The mere fact that material misrepresentations or omissions are made as part of the scheme does not preclude claims that the scheme involved a violation of Sections 17(a)(1) and (3) of the Securities Act and Rule 10b-5(a) and (c) of the Exchange Act. *United States v. Bilotti*, 380 F.2d 649, 657 (2nd Cir. 1967) (nondisclosures may be part of a scheme to defraud); *United States v. Rybicki*, 354 F.3d 124, 146 n.20 (2nd Cir. 2003) (quoting *United States v. Autuori*, 212 F.3d 105, 115 (2nd Cir. 2000) ("the phrase 'scheme or artifice to defraud' requires 'material misrepresentations'")). *See also Affiliated Ute Citizens of Utah v. United States*, 406 U.S. 128, 153 (1972) (scheme liability under Rule 10b-5(a) and (c) established even though case was one "involving primarily a failure to disclose"). Furthermore, as discussed above, a respondent who makes a false statement may be held liable for participating in a fraudulent scheme involving that statement even if he was not the "maker" of the statement under *Janus*. *Lucent,* 610 F. Supp. 2d at 361. *See also Sells*, 2012 WL 3242551 at *7 (denying motion to dismiss on Rule 10b-5(a) and (c) claims and concluding that allowing liability for defendants' alleged conduct under Rule 10b-5(a) and (c) would not make *Janus* meaningless because *Janus* did not address these sections).

(2) The Respondents' Deceptive Conduct

UBS PR, Ferrer and Ortiz all participated in a fraudulent scheme that deceived investors into purchasing and holding CEFs in 2008 and 2009, and caused them losses by preventing them from selling their CEF shares in 2009. The misrepresentations, omissions, and additional conduct of all three participants in the scheme are numerous:

- Ortiz, as head of the trading desk, supervised and was responsible for UBS PR's 2009 conduct in lowering prices to sell ahead of customers. This conduct of lowering prices was in addition to misrepresentations and omissions he made.

- Ortiz deceived financial advisors when he transmitted inventory sheets to them in the fall of 2008 and early 2009 that misrepresented the total CEF shares in inventory in each Fund, thereby misleading financial advisors about the liquidity of the secondary market.

- UBS PR continued to accept limit orders from customers and financial advisors in 2009 without disclosing it was actively undercutting those orders. Ortiz, as head of the trading desk, was responsible for this deceptive conduct.

- UBS PR made misstatements and omissions in its 2008 prospectuses and the Family of Funds brochure that market forces such as supply and demand determined prices when factors other than supply and demand such as the desire to maintain stable yields to attract investors and to lower prices below customers' orders were responsible for pricing decisions.

- UBS PR made further misrepresentations and omissions in those documents when it stated in 2009 it intended to maintain a market in the CEFs but could stop at any time when, in fact, it had already stopped.

- Ferrer and Ortiz knew as discussed above these statements were false, but failed to disclose the truth about the CEFs when Ferrer was interviewed in *El Vocero*, when Ortiz addressed investors at the March 2009 conference, and when they spoke to financial advisors in 2008 and 2009.

- Ferrer misled financial advisors in 2008 when he explained the advantages of CEFs for clients, but did not disclose UBS PR's trading desk was artificially propping up prices by buying shares into inventory and that sellers far outnumbered buyers.

- UBS PR, Ferrer, and Ortiz misled customers and financial advisors in 2009 when UBS PR lowered CEF inventory prices below customers' sell orders and all three did not disclose this fact and continued to maintain market forces such as supply and demand set prices.

- Ferrer misled financial advisors in 2008 when he touted the advantages of CEFs for clients, dismissed concerns about a sluggish secondary market, and directed the firm to issue two new CEFs, but did not disclose UBS PR's trading desk was artificially propping up prices by buying shares into inventory, and was repeatedly asking its parent company to increase its inventory capacity to hide the significantly decreasing demand for CEFs.

- UBS misled investors when it published a list of CEF "prices" in *El Vocero* and did not disclose: (1) the "prices" included three percent sales commissions; (2) UBS PR was not committing to buy any shares in 2009 when it published the "prices"; and (3) even when UBS PR was buying shares, the "prices" in the newspaper were on many occasions above even what the trading desk was willing to pay;

- Ortiz supervised and was responsible for the process that transmitted prices to *El Vocero* to publish and resulted in UBS PR's misrepresentations;

- UBS PR made misrepresentations and omissions to investors when it transmitted "prices" to UBS to include as actual market values in their account statements. In reality, these "market values" were really indicative bids – estimates of what prices should be.

- Again, Ortiz was responsible for and supervised the process of transmitting these account statement values to UBS. This was deceptive conduct in addition to his misstatements.

- Ortiz further deceived financial advisors from March 4, 2009 through September 30, 2009, when he instructed Rosado to transmit the daily GTC book to the sales force which purported to provide transparent marketable customer sell order prices, without disclosing he had directed Rosado to undercut marketable customer sell orders so UBS PR could liquidate its own CEF inventory.

- UBS PR, Ortiz, and Ferrer all failed to disclose UBS PR's conflict of interest in putting its own interests ahead of customers.[9]

- Ferrer engaged in deceptive conduct when he took steps to ensure UBS PR issued the two new primary offerings in the fall of 2008 and heavily marketed them while at the same time he concealed the truth about the existing CEF market from financial advisors and investors.

Under the standards in the cases set forth above, Ferrer and Ortiz were substantial participants in, and in many cases directly responsible for, the deceptive scheme and fraudulent conduct that deceived and harmed investors. Their misrepresentations and omissions to investors and financial advisors in 2008 and 2009, set forth in detail in Section V(A) above, played an instrumental role in the scheme. Furthermore, both engaged in additional deceptive conduct, such as transmitting false and misleading inventory sheets to financial advisors, lowering CEF trading prices below customer sell orders, and transmitting inaccurate "prices" to *El Vocero*, that renders them liable as participants in a fraudulent scheme under the legal standards set forth above.

As also discussed in Section V(A), Ferrer and Ortiz displayed the highest degree of scienter. As Chairman and CEO of UBS PR, Ferrer had full knowledge of the growing illiquidity of the CEF secondary market in 2008. Ortiz regularly kept Ferrer abreast of trading desk developments, including the lack of demand for the Funds and the repeated requests for inventory increases. Nevertheless, Ferrer pressured financial advisors to aggressively sell the CEFs, telling them CEF "market prices" would continue generating high returns for investors. Ferrer's knowledge of the harm the 2009 inventory dump caused investors is clear in his emails

[9] The Respondents had a duty to disclose to customers the conflict of interest concerning the CEF inventory dump. Courts have found disclosure obligations arise with conflicts of interest involving similar conduct. *In re Merrill Lynch Auction Rate Sec. Litig.*, 2011 WL 536437 (S.D.N.Y. Feb. 9, 2011); *In re UBS Auction Rate Sec. Litig.*, 2010 WL 2541166 (S.D.N.Y. June 10, 2010); *In re Bank of America Corp. Auction Rate Sec. (ARS) Marketing Litig.*, 2011 WL 740902 (N.D. Cal. Feb. 24, 2011). The fraud lies not in the practice of selling stocks contrary to recommendations, but in the failure to disclose that practice to potential investors and readers. *Corporate Relations Group*, 2003 WL 25570113 at *8.

to Price and Hoekstra complaining about the problems. He estimated $250 million in investor losses, yet continued to tell financial advisors to press ahead with sales without disclosing the truth about the Funds to them.

As the Head of Capital Markets at UBS PR, Ortiz had perhaps the greatest knowledge of the severity of the supply and demand imbalance. Ortiz controlled CEF pricing decisions and, notwithstanding increasing evidence the CEFs were priced too high given the decreasing demand, he refused to lower prices and instead repeatedly requested increased inventory levels. He was aware of increasing complaints by the financial advisors of their inability to sell their customers' CEF shares. Ortiz approved the transmission of inaccurate prices to *El Vocero.* Ortiz also spoke at the 2009 investor conference, touting the outstanding performance and liquidity of the CEFs, without disclosing the inventory and price reductions. During that time, he held meetings with the sales force to falsely tell them market forces were behind the decreases in CEF prices. He clearly displayed scienter.

Finally, as discussed above, the fraudulent scheme occurred in connection with the purchase of and in the offer or sale of securities – the CEF shares. For all those reasons, the Law Judge should find Ortiz and Ferrer liable under Sections 17(a) and 10(b) as participants in a fraudulent scheme.

### *C. Ferrer And Ortiz Aided And Abetted UBS PR's Securities Violations*

#### (1) Standards For Aiding And Abetting

Aiding and abetting violations of the securities laws involves three elements: (1) a primary violation by another party; (2) a general awareness by the aider and abettor that his or her role was part of an overall activity that was improper; and (3) the aider and abettor knowingly and substantially assisted in the conduct that constituted the primary violation. *Woods* *v. Barnett Bank of Fort Lauderdale*, 765 F.2d 1004, 1009 (11th Cir. 1985); *Investors Research Corp. v. SEC*, 628 F.2d 168, 178 (D.C. Cir. 1980); *Woodward v. Metro Bank of Dallas*, 522 F.2d 84, 94-97 (5th Cir. 1975); *Howard v. SEC*, 376 F.3d 1136, 1151 (D.C. Cir. 2004).

The awareness requirement can be satisfied by actual knowledge or extreme recklessness, which can be shown by "red flags," "suspicious events creating reasons for doubt," or "a danger . . . so obvious that the actor must have been aware of" the danger of violations. *Howard*, 376 F.3d at 1143 (citations omitted). The knowledge or awareness requirement can be satisfied by recklessness when the alleged aider and abettor is a fiduciary or active participant. *Ross v. Bolton*, 904 F.2d 819, 824 (2nd Cir. 1990); *Rolf v. Blythe & Co. Inc.*, 570 F.2d 38, 47-48 (2nd Cir. 1978); *Woodward*, 522 F.2d at 97.

To "substantially assist" a securities violation, a respondent must: (1) in some way associate himself with the venture; (2) participate in it as in something that he wished to bring about; and (3) have sought by his action to make it succeed. *SEC v. Apuzzo*, 2012 WL 3194303 at *6 (2nd Cir. Aug. 8, 2012), *citing United States v. Peoni,* 100 F.2d 401-02 (2nd Cir. 1938). The Division establishes "substantial assistance" by showing that a respondent "joined the specific venture and shared in it, and that his efforts contributed to its success, or, in other words, by showing that the defendant consciously assisted the commission of the specific [violation] in some active way." *SEC v. DiBella*, 587 F.3d 553, 566 (2nd Cir. 2009) (quoting *United States v. Ogando*, 547 F.3d 102, 107 (2nd Cir. 2008)); *see also Armstrong v. McAlpin*, 699 F.2d 79, 91 (2nd Cir. 1983) (holding that even "inaction on the part of the alleged aider and abettor" may be "treated as substantial assistance...when it was designed intentionally to aid the primary fraud or it was in conscious and reckless violation of a duty to act"). The element of substantial assistance is met when, based upon all the circumstances surrounding the conduct in question, a respondent's actions are a "substantial causal factor" in bringing about the primary violation. *Woods*, 765 F.2d at 1013; *Blyth, Eastman*, 570 F. 2d at 48 ("substantial causal factor").

(2) UBS PR's Primary Violations

As set forth above, UBS PR violated Section 17(a) of the Securities Act and Section 10(b) and Rule 10b-5 of the Exchange Act through misrepresentations, omissions and fraudulent conduct. UBS PR gave the false impression that supply and demand was responsible for CEF prices, and the CEF market was both competitive and liquid. This includes the following misrepresentations and omissions:

- 2008 Fund prospectuses the firm provided to investors and published on its website and the Family of Funds Brochure misrepresented that market forces such as supply and demand determined CEF prices, when in fact pricing decisions depended primarily on the firm's desire to maintain stable prices and yields to attract investors and, later, to lower prices below customers' pending sell orders;

- UBS PR made further misrepresentations and omissions in those documents when it stated in 2009 it intended to maintain a market in the CEFs but could stop at any time when, in fact, it had already stopped.

- UBS PR misled customers and financial advisors in 2009 when it lowered CEF inventory prices below customers' sell orders but did not disclose this fact and continued to maintain market forces such as supply and demand set prices.

- UBS PR misled investors when it published a list of CEF "prices" in *El Vocero* and did not disclose: (1) the "prices" included three percent sales commissions; (2) UBS PR was not committing to buy any shares in 2009 when it published the "prices"; and (3) even when UBS PR was buying shares, the "prices" in the newspaper were on many occasions above even what the trading desk was willing to pay;

- UBS PR made misrepresentations and omissions to investors when it transmitted "prices" to UBS to include as actual market values in their account statements. In reality, these "market values" were really indicative bids – estimates of what prices should be.

- UBS PR failed to disclose its conflict of interest in putting its own interests ahead of customers when it sold CEFs from its inventory by undercutting its customers sell orders.

These misrepresentations and omissions were material for the same reasons discussed above in Section V(A). The scienter of Ferrer and Ortiz, also discussed in Section V(A), is imputed to UBS PR because of their positions as senior officers of the firm. *See SEC v. Manor Nursing Centers*, 458 F.2d 1082, 1096 n.16 (2nd Cir. 1971). Finally, the misrepresentations and omissions occurred in connection with the purchase or in the offer and sale of securities – the CEF shares. Among other uses of interstate commerce, Ferrer and Ortiz used email to communicate with other UBS PR and UBS executives, and investors and financial advisors used the telephone, wires and checks to purchase CEF shares. Therefore, UBS PR committed primary violations of Section 17(a)(2) and 10(b) and 10b-5(b).

(3) Ferrer and Ortiz Knowingly Substantially Assisted UBS PR's Primary Violations

Ferrer and Ortiz, through their statements, nondisclosures and other conduct, knowingly and substantially assisted UBS PR's misrepresentations and omissions to investors and financial advisors. In many cases, UBS PR's violations are imputed to the company primarily from Ferrer and Ortiz's conduct. In other instances, Ferrer and Ortiz engaged in conduct they knew helped the firm mislead its customers with respect to the pricing and liquidity of CEFs.

(i) Ferrer

Ferrer aided UBS PR in defrauding its financial advisors and customers when he sent numerous emails to UBS PR's financial advisors as part of the firm's campaign to boost flagging demand for CEFs in 2008 and early 2009.

Ferrer's emails were misleading because he touted the CEFs as good investments with low volatility and superior returns, and dismissed concerns about a sluggish secondary market. But he did not disclose that UBS PR's trading desk was artificially propping up prices by buying shares into inventory, and was repeatedly asking its parent company to increase its inventory capacity to hide the significantly decreasing demand for CEFs. Ferrer's misleading emails deliberately helped the firm to hide the extent of CEF liquidity problems from financial advisors and investors, in part to permit two lucrative new CEF issues to occur in the fall of 2008.

Ferrer also knowingly helped UBS PR misrepresent that supply and demand was responsible for CEF prices, and that there was an active market for CEFs, in numerous emails in 2008 and 2009. Ferrer knew that, in fact, UBS PR was setting prices primarily to maintain particular yields or, later, to sell its inventory to comply with its corporate parent's mandate.

Ferrer's emails after the 2009 investor conference also show he aided UBS PR's misrepresentations and omissions to investors. After the conference, which Ferrer attended and at which Ortiz made numerous material misrepresentations and omissions, Ferrer sent another email repeating some of the misleading information about CEF liquidity and returns to financial advisors. Thus, Ferrer knowingly helped UBS PR mislead financial advisors by indicating the information communicated at the conference was accurate, when he knew it was misleading and incomplete.

Ferrer also substantially assisted in the firm's CEF inventory dump in 2009. When Ferrer was interviewed in *El Vocero* in April 2009, he failed to disclose the persistent illiquidity in the CEF markets and UBS' March 2009 decision to drastically reduce CEF inventory. Later, Ferrer continued to urge financial advisors to recommend CEFs to their customers even though he knew the firm was no longer placing firm bids to buy CEF shares. He also knew the trading desk was lowering CEF prices in the course of selling its inventory, putting its own financial interest ahead of customers' interests.

Through his actions, statements, and failures to disclose information, Ferrer knowingly aided in UBS PR's fraudulent misrepresentations and omissions to financial advisors and investors.

(ii) Ortiz

Ortiz also knowingly helped UBS PR misrepresent and omit material information about the CEFs. As discussed above, Ortiz made what he knew were misleading statements about CEF liquidity and returns at UBS PR's 2009 investor conference. Ortiz further assisted UBS PR to mislead investors and financial advisors by not disclosing in 2009 that, to comply with UBS' demand to reduce inventory, he developed a plan to buy the minimum amount of customer shares possible and lower CEF prices below customer sell orders.

Ortiz also knowingly helped UBS PR mislead customers about CEF prices because he supervised and was responsible for setting CEF prices. In that role, he was responsible for the process that transmitted the misleading prices to *El Vocero* to publish, and to be included in customers' monthly UBS PR account statements. Ortiz was aware that, contrary to UBS PR's statements in the Family of Funds Brochure and the 2008 Fund prospectuses, CEF prices were set primarily to ensure a particular yield and for price stability.

Therefore, through his deceptive conduct and nondisclosures, Ortiz knowingly and substantially assisted in UBS PR's fraudulent misrepresentations and omissions to financial advisors and investors.

In addition, UBS PR willfully committed primary violations of Section 10(b) and Rule 10b-5(a) and (c), and 17(a)(1) and (3) by engaging in a deceptive scheme, as discussed above in Section V(B)(2). Through their conduct, including their misrepresentations and nondisclosures, Ferrer and Ortiz provided knowing, substantial assistance to UBS PR's scheme for the same reasons they were participants in that scheme. Ferrer and Ortiz's knowing participation in the scheme with UBS PR also establishes their liability for aiding and abetting UBS PR's scheme.

*D. Aiding And Abetting Violations Of Section 15(c) Of The Exchange Act*

Section 15(c)(1)(A) of the Exchange Act prohibits any broker or dealer from using the mails or other means 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." Scienter is required to establish a violation of Section 15(c)(1)(A). *SEC v. Dowdell*, 2002 WL 424595 at *6 (W.D. Va. March 14, 2002) ("The same scienter requirement attributed to Section 17(a)(1) and Section 10(b) violations applies to 15(c)(1) violations.").

UBS PR, a registered broker-dealer, willfully violated Section 15(c)(1)(A) by its deceptive conduct, including its material misrepresentations and omissions, as described in the preceding section, to induce investors into purchasing and holding CEFs in 2008 and 2009.

Through their actions, including their misrepresentations, nondisclosures, and deceptive conduct participating in the scheme, Ferrer and Ortiz provided knowing, substantial assistance to UBS PR's deception designed to induce or in an attempt to induce, the purchase or sale of the CEFs. Ferrer and Ortiz' fraudulent misrepresentations, omissions and other deceptive conduct, as discussed above, demonstrate: their association with UBS PR's primary violation of Section 15(c); their aim to carry it out; their awareness the activity was improper; and their knowing substantial assistance of the violation. In other words, it establishes their liability for aiding and abetting UBS PR's primary violations of Section 15(c).

## VI. SANCTIONS

The Division of Enforcement is asking for the following sanctions against Ortiz and Ferrer: cease-and-desist orders, industry bars, disgorgement, and civil penalties.

*A. Cease-and-Desist Orders*

Sections 15(b) and 21C of the Exchange Act and Section 8A of the Securities Act empower the Commission to order a person who has been found, after notice and hearing, to have violated or caused any violation of those Acts, to cease and desist from committing or causing such violations and any future violations.

The factors for considering whether a cease-and-desist order is warranted are very similar to the factors set forth in *Steadman v. SEC*, 603 F.2d 1126, 1140 (5th Cir. 1979), with added emphasis on the possibility of future violations. *KPMG Peat Marwick, LLP*, Exchange Act Release No. 34-43862 (Jan. 19, 2001), *aff'd sub nom KPMG v. SEC,* 289 F.3d 109 (D.C. Cir. 2002). The *Steadman* factors are: (1) the egregiousness of a respondent's actions, (2) the isolated or recurrent nature of his securities law infractions, (3) the degree of scienter involved, (4) the respondent's assurances against future violations, (5) the respondent's recognition of the wrongful nature of his conduct, and (6) the likelihood the respondent's occupation will present opportunities for future violations. *Steadman*, 603 F.2d at 1140. No one factor controls. *SEC v. Fehn*, 97 F.3d 1276, 1295-96 (9th Cir. 1996). The severity of the sanction appropriate in a particular case depends on the facts of the case and the value of the sanction in preventing recurrence. *Berko v. SEC*, 316 F.2d 137, 141 (2nd Cir. 1963); *In the Matter of Leo Glassman*, File No. 3-3758, 1975 WL 160534 at *2 (Dec. 16, 1975).

Here, all the factors weigh in favor of the Law Judge imposing cease-and-desist orders on both Respondents. Their actions were highly egregious. Their misrepresentations, omissions and deceptive conduct ensured that their employer, a registered broker-dealer, preyed on elderly and unsophisticated investors looking to protect their retirement savings. Their conduct enabled UBS PR to attract thousands of unsuspecting investors into buying and holding CEFs, as well as prevented many of those same customers from selling their holdings to avoid further losses. They engaged in this conduct for the most selfish of reasons – their own financial interests. As a result of their conduct, thousands of investors lost more than $600 million. It is hard to imagine any more egregious conduct.

The actions of Ferrer and Ortiz were also recurrent. They continued for almost 18 months and involved a variety of different misrepresentations, omissions, and deceptive conduct. Ferrer and Ortiz first made a number of statements and engaged in conduct to keep prices artificially high and mask CEF market illiquidity from investors and financial advisors in 2008 and early 2009. Then they made further misrepresentations and omissions and engaged in further fraudulent conduct from March through September 2009 to lower CEF prices to undercut customer sell orders. When they publicly discussed the CEF market, they failed to disclose these crucial facts. Accordingly, their conduct spanned a significant amount of time and involved numerous misstatements, omissions and deceptive actions.

As discussed in several sections above, Ferrer and Ortiz displayed a high degree of scienter since they knew the facts they and UBS PR were publicly disseminating about the CEFs in 2008 and 2009 were not true. As to the fourth and fifth factors, Ferrer and Ortiz have not acknowledged the wrongfulness of their conduct; consequently they have not given and cannot give any assurances against future misconduct. Finally, both Ferrer and Ortiz remained employed at UBS PR and will have the opportunity to re-offend.

For all those reasons, the Law Judge should enter cease-and-desist orders against both Respondents.

*B. The Law Judge Should Impose Industry Bars Against Both Respondents*

The same six *Steadman* factors apply to the consideration of a broker-dealer and related industry bars against Ferrer and Ortiz. Here, applying the *Steadman* factors as we did in the immediately preceding section weighs heavily in favor of permanently barring Ferrer and Ortiz from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization. The Commission has held conduct like that of Ferrer and Ortiz, which violates the antifraud provisions of the federal securities laws, "is especially serious and subject to the severest of sanctions under the securities laws." *In the Matter of Jose P. Zollino,* File No. 3-11536, 2007 WL 98919 at *5 (Jan. 16, 2007).

Here, the Division requests that the Law Judge collaterally bar Ortiz and Ferrer from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization ("NRSRO"). Section 925 of the Dodd-Frank Wall Street Reform and Consumer Protection Act authorized the Commission to impose collateral bars in proceedings pursuant to Section 15(b) of the Exchange Act by amending Section 15(b)(6)(A) to "bar any such person from being associated with a broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization." P.L. 111-203 (July 21, 2010). The collateral bars Dodd-Frank authorized prohibit securities professionals found to have violated the securities laws from associating with any of the Commission-regulated entities specified in amended Exchange Act Section 15(b)(6)(A).

The Dodd-Frank Act's collateral bar provisions are applicable here even though the statute was not enacted until July 21, 2010, after the date of the conduct at issue. Although courts will not retroactively apply a statute under certain circumstances, "application of new statutes passed after the events in suit is unquestionably proper in many situations." *Landgraf v. USI Film Prods.*, 511 U.S. 244, 273 (1994). For instance, in *Landgraf*, the Supreme Court stated "[w]hen the intervening statute authorizes or affects the propriety of prospective relief, application of the new provision is not retroactive" and is thus permitted. *Id.* One example of such prospective relief the *Landgraf* court specified is "relief by injunction" which necessarily "operates *in futuro*." *Id.* at 274. Because collateral bars, like the bar we seek against Ortiz and Ferrer, are prospective relief designed to protect the public "*in futuro*," retroactivity concerns are not implicated by application of the Dodd-Frank collateral bar provisions.[10]

Since long before Dodd-Frank was enacted, Section 15(b)(6)(A) of the Exchange Act has provided that the Commission may bar a person associated with a broker-dealer who is found liable for certain misconduct from further association with a broker-dealer, if such a bar was "in the public interest" and certain specified criteria were satisfied. Section 925 of the Dodd-Frank Act amended that section of the Exchange Act to permit the Commission to bar such an individual not only from association with a broker-dealer, but also from association with the other regulated entities enumerated in the amendment. The Commission's collateral bar authority under amended Section 15(b)(6)(A) is a prospective remedy based on misconduct that was unlawful even prior to enactment of the Dodd-Frank Act. Consequently, a collateral bar against Ferrer and Ortiz would limit their conduct only *in futuro*. In this respect, the collateral bar sought here is indistinguishable from the prospective injunctive relief the *Landgraf* Court held does not raise retroactivity concerns.

Further, imposing a collateral bar is a remedial measure designed to protect the investing public from harm. Section 15(b)(6)(A) expressly provides a bar is appropriate only if "in the public interest," a phrase the Commission and the courts have interpreted to mean the remedy is not "punitive" but rather is "meant to protect the investing public." *Rizek v. SEC*, 215 F.3d 157,

[10] *But see*, *In the Matter of John W. Lawton*, 2011 WL 1621014 at *4 (Initial Decision April 29, 2011) (concluding in a follow-on proceeding pursuant to Section 203(f) of the Advisers Act, also amended by Dodd-Frank to provide collateral bar authority, that barring respondent from association with municipal advisors or nationally recognized statistical rating organizations constituted improper retroactive relief and declining to order such relief, but imposing a bar as to association with the other types of regulated entities enumerated in the amended Section 203(f) because such bars were statutory remedies available before Dodd-Frank).

163 (1st Cir. 2000). *See also Kornman v. SEC*, 592 F.3d 173, 188 (D.C. Cir. 2010) (holding a bar was "remedial in nature because it is designed to protect the public, and the sanction is not historically viewed as punishment" (internal quotation marks omitted)); *Brownson v. SEC*, 66 Fed. Appx. 687, 688 (9th Cir. 2003) (noting "the SEC's goal of protecting the public is remedial, not punitive"); *Vanasco v. SEC*, 395 F.2d 349, 353 (2nd Cir. 1968) (concluding a bar was "in the public interest" because it was based on the belief "the public should [not] be exposed to further risk of fraudulent conduct"). Such prospective remedial relief designed to protect the public is appropriate even if based on misconduct committed prior to enactment of the statute in question. *Landgraf*, 511 U.S. at 274.

In light of these legal principles, a collateral bar is an appropriate remedy against Ferrer and Ortiz. Further, their demonstrated egregious fraudulent conduct clearly warrants collaterally barring them from association with any regulated entity.

## *C. Disgorgement*

As discussed above, the facts at the hearing will show the Respondents violated the federal securities laws. The facts will also show that Respondents profited from their illegal conduct by receiving incentive compensation based in part on UBS PR's financial performance. The CEFs accounted for the majority of UBS PR's revenues between May 2008 and September 2009. Under the circumstances, it would be inequitable to allow them to keep that money.

Disgorgement is an equitable remedy designed both to deprive a wrongdoer of his unjust enrichment and to deter others from violating the securities laws. *SEC v. Blatt*, 583 F.2d 1325, 1335 (5th Cir. 1978); *SEC v. First City Fin. Corp.*, 890 F.2d 1215, 1230 (D.C. Cir. 1989); *Manor Nursing Centers*, 458 F.2d at 1103-1104 ("The effective enforcement of the federal securities laws requires that the SEC be able to make violations unprofitable"). The Law Judge "has broad discretion not only in determining whether or not to order disgorgement but also in calculating the amount to be disgorged." *First Jersey*, 101 F.3d at 1475.

The Division is entitled to disgorgement "upon producing a reasonable approximation of a defendant's ill-gotten gains." *SEC v. Calvo*, 378 F.3d 1211, 1217 (11th Cir. 2004). The [Division's] burden for showing "the amount of assets subject to disgorgement . . . is light: . . . . Exactitude is not a requirement.'" *SEC v. ETS Payphones, Inc.*, 408 F.3d 727 at 735 (11th Cir. 2005). Once the Division presents evidence reasonably approximating the amount of a respondent's ill-gotten gains, the burden of proof on the amount the respondent received shifts to the respondent. *First City*, 890 F.2d at 1232; *SEC v. Hughes Capital Corp.*, 917 F. Supp. 1080, 1085 (D. N.J. 1996), *aff'd* 124 F.3d 449 (3rd Cir. 1997). The respondent is then "obliged clearly to demonstrate that the disgorgement figure [is] not a reasonable approximation." *First City*, 890 F.2d at 1232.

The Division will present at the hearing evidence demonstrating that Ferrer and Ortiz received ill-gotten gains in the form of incentive compensation based in large part on CEF revenues.

In addition to disgorgement, pre-judgment interest is equitable in these circumstances. The Respondents have enjoyed access to their ill-gotten gains over a period of time. To require payment of prejudgment interest is consistent with the equitable purpose of the remedy of disgorgement. *Hughes Capital*, 917 F. Supp. at 1090.

Pre-judgment interest should be calculated in accordance with the delinquent tax rate established by the Internal Revenue Service, 26 U.S.C. § 6621(a)(2), and assessed on a quarterly basis, from May 1, 2008, the beginning of the relevant period to the date the judgment is entered. The rate of interest "reflects what it would have cost to borrow money from the government and therefore reasonably approximates one of the benefits the defendant received." *First Jersey*, 101 F. 3d at 1476.

## *D. Civil Penalties*

The Commission seeks civil penalties against Ferrer and Ortiz pursuant to Section 21B(a) of the Exchange Act, Section 8A of the Securities Act, and Section 9(d) of the Investment Company Act. The purpose of civil penalties is to punish the individual violator as well as deter future violations. *SEC v. Palmisano,* 135 F.3d 860, 866 (2nd Cir. 1998); *SEC v. K.W. Brown*, 55 F. Supp. 2d 1275, 1314 (S.D. Fla. 2007); *SEC v. Tanner,* 02 Civ. 0306, 2003 WL 21523978 at *2 (S.D.N.Y. July 3, 2003); *SEC v. Kenton Capital, Ltd.*, 69 F. Supp. 2d 1, 17 (D.D.C. 1998); *SEC v. Moran,* 944 F. Supp. 286, 296 (S.D.N.Y. 1996). As set forth in H.R. Report No. 616 - the Report of the Committee on Energy and Commerce of the U.S. House of Representatives on the Remedy Act,

> [T]he money penalties proposed in this legislation are needed to provide financial disincentives to securities law violations other than insider trading ... Disgorgement merely requires the return of wrongfully obtained profits; it does not result in any actual economic penalty or act as a financial disincentive to engage in securities fraud .... The Committee therefore concluded that authority to seek or impose substantial money penalties, in addition to the disgorgement of profits, is necessary for the deterrence of securities law violations that otherwise may provide great financial returns to the violator. (Citations omitted).

1990 WL 256464 *20, 1990 U.S.C.C.A.N. 1379 *1384 (Leg. Hist.), H.R. Rep. 101-616, H.R. Rep. No. 616, 101st Cong., 2nd Sess. 1990.

Section 21(d)(3) of the Exchange Act and the other sections set forth above provide for three tiers of penalties. Under the First Tier, the Court may impose a penalty of up to (i) $7,500 on an individual defendant for each violation or (ii) the gross amount of pecuniary gain to the defendant as a result of the violation. Under the Second Tier, the Court may impose a penalty of up to (i) $75,000 on an individual defendant for each violation or (ii) the gross amount of pecuniary gain to the defendant as a result of the violation. The Second Tier applies where the violation involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement.

Finally, under the Third Tier the Court may impose a penalty of up to (i) $150,000 on an individual defendant for each violation or (ii) the gross amount of pecuniary gain to the defendant as a result of the violation.[11] *SEC v. KS Advisors, Inc.*, 2006 WL 288227, at *3 (M.D. Fla. Feb. 6, 2006). The Third Tier applies to cases in which the requirements of a Second Tier penalty are present *and* the violation directly or indirectly resulted in substantial losses or created a significant risk of substantial losses to other persons.

The actions of Ferrer and Ortiz merit a Third Tier penalty because they involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement, and directly or indirectly resulted in substantial losses or created a significant risk of substantial losses to other persons. *Meadows v. SEC*, 119 F.3d 1219, 1228 (5th Cir. 1997).

Courts have determined that a violation occurs each time a respondent has acted to violate the securities laws. *See SEC v. Lazare Indus., Inc.*, 294 Fed. Appx. 711, 715 (3rd Cir. 2008) (for the purposes of assessing reasonableness of district court's assessment of $500,000 penalty, court considered each sale of unregistered stock as a separate violation); *SEC v. Coates*, 137 F. Supp. 2d 413, 430 (S.D.N.Y. 2001) (court calculated penalty by multiplying number of misrepresentations by penalty amount). Therefore, the Law Judge could impose a penalty of $150,000 for *each* of the violations that occurred in this case.

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[11] The figures for all three tiers come from the Federal Civil Penalties Inflation Adjustment Act of 1990, which adjusted the potential penalty amounts to account for inflation based on violation dates. 17 C.F.R. §§201.1001-1003. The figures here were updated in February 2009, in the middle of the fraudulent conduct.

Factors courts consider when assessing a civil penalty include the egregiousness of the violation, the isolated or repeated nature of the violations, the degree of scienter involved and the deterrent effect given the defendant's financial worth. *K.W. Brown*, 555 F. Supp. 2d at 1315; *SEC v. Yun,* 148 F. Supp. 2d 1287 (M.D. Fla. 2001). Application of these factors to Ferrer and Ortiz merits a high penalty for both. As discussed above, their conduct was egregious and recurrent, and both demonstrated a high degree of scienter. Moreover, based upon the public policy objective of deterrence, the Division submits a substantial penalty is necessary and appropriate to punish the Respondents for their unlawful activities and deter others from engaging in violations of the federal securities laws.

## VII. CONCLUSION

For the foregoing reasons, the Law Judge should find Ferrer and Ortiz violated Section 17(a) of the Securities Act and Section 10(b) and Rule 10b-5 of the Exchange Act. Furthermore, the evidence will show the Respondents aided and abetted UBS PR's violations of those sections and Section 15(c) of the Exchange Act. We believe the evidence and the law support the sanctions we will ask the Law Judge to impose.

Respectfully submitted,

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