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UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-14862

In the Matter of

MIGUEL A. FERRER, and
CARLOS J. ORTIZ,

Respondents.

RESPONDENT CARLOS J. ORTIZ'S
PRE-HEARING MEMORANDUM

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PRELIMINARY STATEMENT

The Division's Order charges Respondent Carlos J. Ortiz with deliberately or negligently participating in a scheme to defraud customers of UBS Financial Services, Inc. of Puerto Rico ("UBS PR" or the "Firm"). The essence of these potentially career-ending charges is the claim that Mr. Ortiz artificially inflated the price of certain over-the-counter closed-end funds (the "Funds") by buying their shares into the Firm's inventory at a high price, and then later selling the shares to customers at a lower price, without making appropriate disclosures. The Division has leveled these charges even though no witness will testify that such a scheme to manipulate the market ever existed. Moreover, Mr. Ortiz, who supervised UBS PR's trading desk ("Desk"), had no control over disclosure decisions, kept all constituencies within UBS fully informed of the Desk's actions, and suggested to the relevant UBS experts consideration of whether further disclosures were required (these experts, however, concluded that no further disclosures were needed). As will be shown at trial, the case against Mr. Ortiz is logically implausible, factually wrong, legally unprecedented, and fundamentally misdirected.

Logically implausible because the Division's "buy high/sell low" theory—that UBS systematically expended its own capital to consciously overpay for securities it then sold a few months later at a loss—makes no sense. It would be fundamentally unfair to infer fraudulent intent in such circumstances, particularly where a coherent explanation is readily apparent. While inconsistent with an intent to disadvantage customers, UBS' actions are consistent with good faith efforts to provide appropriate liquidity to the market at times of unprecedented worldwide stress and uncertainty. The global crisis that exploded with the collapse of Lehman Brothers, AIG, Fannie Mae, and other bedrock institutions in early September 2008, was unprecedented. Far from the Division's notion that UBS decided then to manipulate a market by overpaying to purchase securities, logic points to a more obvious conclusion—that UBS was

acting responsibly to maintain an orderly market through the judicious purchase into inventory of a modest volume of shares, followed by the disposition of those shares when the market stabilized, at prices it believed in good faith were reasonable.

Factually wrong because the Division's Order not only ignores critical elements like the panic following Lehman's September 2008 collapse, and UBS' massive, worldwide deleveraging in 2009 in response to the global financial crisis (over which Mr. Ortiz had no control), it disregards facts specific to the market for the Funds and the Funds themselves. The Division smoothes the rough edges off the actual trading data in order to imagine two simple periods—a "Phase I" spanning the second half of 2008 and the first quarter of 2009, in which Mr. Ortiz was supposedly maintaining the too-high prices the Desk was quoting by buying Fund shares into UBS PR's inventory; and then a "Phase II" from mid-March 2009 through September 2009, in which Mr. Ortiz supposedly drove prices too low by selling those same shares out of inventory at reduced prices. But during the period at issue, UBS' inventory purchases were a small fraction of overall trading and an even smaller fraction of the market capitalization of the Funds (never more than approximately 1%). Customer buying and selling exceeded $1 billion, and relatively miniscule shifts in inventory level (well below 5% of that amount) could not dictate price, particularly in a market with a total capitalization in excess of $5 billion. Moreover, in many of the Funds, inventory levels declined during the so-called Phase I inflationary period, and actually increased during the so-called Phase II deflationary period, the direct opposite of what the Division's theory presumes. By early September 2008, more than four months into the so-called Phase I period, overall inventory was actually lower than it was at the beginning of Phase I. Similarly, inventory levels fell during the month of November 2008, and also fell between January 1, 2009 and March 31, 2009. On a fund-by-fund basis (the way pricing was actually

done), the plain contradictions with the Division's view of the world are even more pronounced. The actual trading data—instead of the Division's over-simplification of it—is inconsistent with the Division's theory of a concerted effort to inflate Fund prices, and fully consistent with good faith efforts to supply liquidity to a market in unprecedented circumstances. The Division's Order disregards all this, tries to draw nefarious connections between disparate facts and events where none exist, and is driven by hindsight accusations rather than a fair assessment of Mr. Ortiz's conduct at the relevant time.

Legally unprecedented because the Division's case is premised on the notion that a trading desk has a duty to disclose its inventory levels and inventory disposition plans to counterparties with which it trades. No court or regulator has ever adopted such a position, and it would be contrary to the law (not to mention policy and industry practice) to do so. Firms regularly trade in over-the-counter markets without disclosing inventory positions. Indeed, a leading treatise on broker-dealer law and regulation has observed that "brokerage firms rarely if ever inform their customers of the size of the firm's inventory of a security that the firm is recommending to them, or the length of time that the firm has held the inventory . . . or information about the firm's trading for its own account in securities that it is recommending to its customers."[1] This practice is supported by sound reasoning: if firms were required to disclose their intentions to reduce or increase their inventories, market participants could front-run those plans, frustrating firms' ability to effectuate reasonable risk-mitigation measures.

And finally, the Division's Order is *fundamentally misdirected* because Mr. Ortiz acted at all times in good faith and with complete transparency. He kept his supervisors apprised of any material actions by the Desk, and everything he did in connection with the Funds at issue in this

[1] *See* Tab 3 (Norman S. Poser & James A. Fanto, *Broker-Dealer Law & Regulation* § 16.03[A][2] at 16-78 (4th ed. 2010)). Citations to "Tab" refer to documents contained in the accompanying Appendix.

case was known to those supervisors (who will testify that they were kept informed of and supported, and still support, the actions taken by the Desk). Beyond Puerto Rico, UBS' risk and legal/compliance personnel based in New Jersey were also aware of the Desk's actions, and supportive. The ultimate irony of this case is that when UBS was seeking to significantly deleverage its balance sheet in the face of the massive losses recognized in 2009, Mr. Ortiz was given a mandate from UBS in New Jersey in late May 2009 to reduce inventory levels below those which had been maintained for many years. Mr. Ortiz respectfully, but firmly, disagreed with that mandate, and set forth his principled reasons for why he viewed it as an ill-advised business decision. He also wrote to UBS' risk management personnel to underscore that the mandated course of action should be reviewed by UBS Legal and Compliance, which then concluded that no further disclosures were required. Having heard Mr. Ortiz's concerns, and vetted them at the highest levels, UBS decided to proceed to reduce its overall inventory position to levels well below the historic norm. While Mr. Ortiz questioned that course of action as a business decision, he had no further reason to question its propriety as a compliance or regulatory matter. Mr. Ortiz thereafter properly and responsibly implemented the mandated course of action, informing at the outset both risk management and senior management (in Puerto Rico <u>and</u> New Jersey) precisely how he planned to do so. If that course of action was unsound as a legal matter—and we are aware of no legal obstacle to a firm choosing to reduce its inventory risk in a particular security in the wake of massive firm-wide losses—the responsibility for it lies not with Mr. Ortiz, but with UBS, which mandated the action, in spite of Mr. Ortiz's urging to the contrary.

Mr. Ortiz has had a stellar, 25-year career in the securities industry, without blemish or complaint. At every juncture in this case he acted in good faith, and transparently. Nothing he

did resulted in any personal financial gain, and he was clear in speaking up to his supervisors, and to UBS Financial Services Inc. (the parent of UBS Puerto Rico) ("UBSFS"), when he felt actions being imposed upon the Desk should be reconsidered. At no time was he ever in a position to know that his conduct was in any way improper, or less than reasonable and ethical. To seek to sanction him now, in the light of misguided hindsight, or, at bottom, for what were corporate actions over which he had no control and with which he did not concur, is fundamentally unfair.

FUND BACKGROUND

Since their inception nearly twenty years ago, closed-end mutual funds in Puerto Rico sponsored and offered by UBS PR have been a tremendous success story.

The Funds owe their origins to legislation enacted by the Commonwealth of Puerto Rico Government in order to specifically provide tax advantages to mutual funds whose holdings are primarily invested in local Puerto Rican securities. They are exempt from the Investment Company Act and are instead regulated by the Office of the Commissioner of Financial Institutions of Puerto Rico, which conducts regular examinations of the Funds. Additionally, Fund shares are also exempt from registration with the SEC, pursuant to a no-action letter issued in August 1994. As a result of these unique tax and registration characteristics, investment in the Funds is restricted to Puerto Rico Residents.

Unlike most domestic closed-end funds, the Funds trade in an over-the-counter market, not on an organized exchange. That means that an owner of Fund shares wishing to sell her shares needs to find a counterparty in Puerto Rico willing to buy those shares at a price acceptable to both. Although it is not obligated to do so, UBS PR has historically facilitated trading in the Funds, either by matching buyers and sellers or by buying into inventory from customers wishing to sell, and selling out of its inventory to customers wishing to buy the Funds.

The Funds have been a success for investors and the Commonwealth. Since 1995, they have generated billions of dollars in capital to finance vital Commonwealth needs, including providing a critical source of funding to the Puerto Rico government and banking sector during the financial crisis that began in 2008. Not a single one of the 23 Funds has ever defaulted on its debt obligations or failed to declare a monthly dividend payment. And they have consistently produced strong returns for their investors. Indeed, since their initial formation, the majority of the Funds have produced strong, tax-advantaged returns. For example, the median annualized 5-year total return for the Funds for the period ending June 30, 2010 was 9.2%.[2] For many of those who purchased and held shares during the period at issue and held them, the returns have been even higher.

CARLOS J. ORTIZ

Shortly after his graduation from the Wharton School at the University of Pennsylvania in 1985, Mr. Ortiz returned to his native Puerto Rico, having joined First Boston (Puerto Rico), Inc., which was subsequently acquired by Popular, Inc. and eventually became Popular Securities, Inc. Working at these institutions from 1985 to 2003, Mr. Ortiz ultimately rose to Managing Director within the Investment Banking Division. His responsibilities were comprehensive, and included municipal, corporate, asset-backed and real estate finance, mergers and acquisitions, government and corporate advisory, and syndicate underwriting. Mr. Ortiz joined UBS PR in June 2003, as Managing Director of its Capital Markets Group, a position he continues to hold today.

Mr. Ortiz has had an unblemished professional record in the securities industry.

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[2] Tab 1 (Expert Report of Erik R. Sirri, PH.D., dated July 23, 2012) (hereinafter "Sirri Report") at ¶ 27. Dr. Sirri's Supplemental Report, dated August 27, 2012, rebutting the Expert Report of the Division's designated expert (hereinafter "Sirri Rebuttal Report") is appended hereto at Tab 2.

A. Mr. Ortiz's Involvement in UBS PR's Fund Pricing Process

Mr. Ortiz does not hold a client-facing role at UBS PR, and he does not have any supervisory position or responsibilities with respect to UBS PR's Financial Advisors ("FAs"). Among Mr. Ortiz's principal responsibilities—and the function most relevant here—is his supervision of the Trading Desk. In this role, Mr. Ortiz supervises the daily trading of the Funds and other products (*e.g.*, municipal bonds), including the evaluation and approval of changes to the bid and offer quotes for the Funds recommended by the traders on the Desk. Desk traders reporting to Mr. Ortiz during the relevant period included Carlos Rosado, Ramon Prats, Daisy Torres, and Max Perez.

At all times relevant to this matter, the Traders and Mr. Ortiz assessed Fund prices pursuant to established Trading Guidelines, which were developed and implemented in 2007 at Mr. Ortiz's recommendation, and in consultation with experienced outside counsel.[3] These guidelines memorialized the Desk's criteria for determining its bid and offer quotes, and contained specific guidance directing the Trading Desk to:

> *employ its best efforts and judgment* to determine . . . the prices for the bids and offers by examining, *among other things,* supply and demand, size of bid and offer quantities, liquidity of particular funds, yield and current yield figures of similar securities, prices in the primary market, and publicly available pricing information (e.g. pricing information published in local newspapers), and . . . the reasonable number of shares of the particular Fund the Firm is willing to trade at the bid/offer price within a reasonable amount of time.[4]

As contemplated by these Guidelines, in assessing the bids and offers the Desk would quote for the Funds, Mr. Ortiz and the traders on the Desk weighed various market factors, and utilized their substantial experience, judgment and expertise in the product and the Puerto Rico securities

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[3] Following a period of market illiquidity resulting from the Puerto Rican fiscal crisis and government shutdown in 2006, UBS PR, at Mr. Ortiz's urging, engaged counsel to review its pricing and order handling policies. In conjunction with this review, the Firm drafted a comprehensive set of guidelines for the Trading Desk, designed, in part, to better equip the Trading Desk to provide orderly market facilitation and to foster customer liquidity in the face of to similar periods of market instability.

[4] Tab 4 (UBSPR-SEC-006-001308-19, at UBSPR-SEC-006-001315) (emphasis added).

market. Each weekday morning—or more frequently if market conditions required—Messrs. Rosado and Prats reviewed the Firm's bid and offer quotes for each Fund and then met with Mr. Ortiz to assess whether the current quotes remained appropriate or required adjustment. If any information came to the Traders' attention suggesting an adjustment to the bid prices would be appropriate to reflect market conditions, they would recommend a change to Mr. Ortiz. Mr. Ortiz would review the relevant information and the rationale for the recommendations with the Traders and make a determination whether to approve the quote adjustment.

The Desk's price discovery process was not set by any mathematical formula or algorithm. It necessarily and reasonably relied on the experience and expertise of Mr. Ortiz, Mr. Rosado, and Mr. Prats—securities professionals also with deep and unique knowledge of the Puerto Rico market—to consider relevant data in assessing the market for the Funds. Mr. Rosado, the senior trader for the Funds, has traded the Funds on a daily basis since 1997, and had worked in the Puerto Rico securities market for over 20 years. Since the end of 2007, Mr. Prats, a securities professional with approximately six years of industry experience, also traded the Funds on a daily basis. And, as noted, Mr. Ortiz had worked in the Puerto Rico securities market for over 25 years and served as Director of the UBS PR's Capital Markets Group since 2003.

B. Mr. Ortiz's Reporting Structure

At all times relevant here, Mr. Ortiz reported to Eugenio Belaval, Regional Director of Wealth Management for UBS PR, who, in turn, reported to Carlos Ubinas, UBS PR's President and Chief Operating Officer. In addition, certain aspects of Mr. Ortiz's activities were supervised and monitored directly by senior members of UBS PR's parent, UBSFS. In particular, UBSFS' Risk Control Committee, a committee of senior UBSFS management plus subject matter experts from risk, legal, compliance, credit and other functions, had oversight over legal, compliance, operational and trading risks related to the UBS PR Trading Desk. Because

maintaining an inventory of Fund shares required committing Firm capital, the Risk Control Committee controlled the amount of Fund inventory the Desk could hold. Principal responsibility for overseeing the risk profile of the Funds' inventory positions rested with Risk Committee members Bernd Michel, Chief Risk Officer for UBSFS U.S. Wealth Management and Jamie Price, former Head of U.S. Wealth Management for UBSFS and Chairman of UBS PR.[5]

The evidence will confirm that Mr. Ortiz was *not* the decision-maker with regard to various increases and decreases in the permitted levels of Fund inventory with which the Division takes issue.

COUNTERSTATEMENT OF FACTS

A. April – August, 2008

In or around April 2008, Mr. Ortiz and others observed that there were more sellers than buyers in the Funds' secondary market resulting in a moderate rise in the Desk's inventory position. To Mr. Ortiz, this appeared to have been caused by client interest in an initial offering of a new Fund (Puerto Rico Fixed Income Fund V), which was offering better yields than other Funds in the UBS PR Closed-End Funds Family at that time. Customers were selling their existing Fund holdings in the secondary market to finance their purchases of this primary offering.[6] Believing that the imbalance would resolve itself by the end of May, when that offering would no longer be available in the primary market, Mr. Ortiz did not think the inventory increase indicated that the underlying market for the shares had shifted. For this reason, rather than reduce the Desk's bid and offer quotes for the affected Funds, Mr. Ortiz requested authority from his supervisors, and from UBSFS risk personnel responsible for

[5] Tom Magdziak, Chief Risk Officer for UBS PR, reported to Bernd Michel and was also involved in the establishment and monitoring of the Desk's inventory limits.

[6] *See* Tab 5 (SEC Ex. 156).

monitoring risk on the Trading Desk, to modestly increase the amount of inventory (that is, Fund shares) the Desk could hold.[7] As he explained in his memorandum to Mr. Michel requesting the inventory limit increase, this would permit the Desk to temporarily buy fund shares from customers wishing to sell, and to hold those shares until the market imbalance resolved and customers interested in purchasing them could be found. Through this relatively routine bridging of a short-term gap between supply and demand, Mr. Ortiz sought to maintain an orderly market for Fund shares. His request was approved and UBS PR's inventory limit was increased from $30 million to $40 million on a temporary basis until May 31, 2008.[8]

The imbalance between buyers and sellers of Funds persisted after the Fixed Income Fund V offering closed. In Mr. Ortiz's judgment, the continued imbalance appeared to be due to the overhang of several imminent municipal paper issuances. So Mr. Ortiz pursued a two-track strategy, electing both to lower bid prices offered by the Desk for some of the Funds in mid-May,[9] and also to seek a further temporary increase in inventory in the beginning of June.[10]

In his June 2008 request for additional, temporary inventory space, Mr. Ortiz projected that the order imbalance would be resolved by August. He was exactly right. The volume of customer share purchases increased, and by the end of August, inventory had fallen back below the level at which it had been when the first request for an increase was approved, and was back within historical ranges.[11]

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7 *See id.*

8 *See id.*

9 *See* Tab 6 (SEC Ex. 4); *see also* Tab 7 (UBS PR Funds: Bid Reductions 5/15/08 – 5/16/08).

10 *See* Tab 8 (UBSPR-SEC-006-027099-100).

11 *See* Tab 9 (August 29, 2008 email from C. Rosado to T. Magdziak, et al.) ("The secondary market funds demand has increase[d] substantially during August 2008 with the exception of some specific funds.. . . . Currently we have USD 27.9 million inventory with a USD 1.3 million GTC order book"); *see also* Tab 10 (July 30, 2008 email from C. Rosado to various persons in risk management and senior management) ("As previously mentioned, we expect to return to normal secondary market conditions by the end of September").

B. September 2008 – March 2009

September 2008 brought truly unprecedented turmoil to world markets, capped by the bankruptcy of Lehman Brothers, the sale of Merrill Lynch to Bank of America, and the Government rescue of AIG. Accompanying these significant events was a spike in yields in the U.S. municipal securities markets, and uncertainty associated with a structural budget deficit in Puerto Rico. The initial reaction in the Funds market was that customer sales began to exceed customer purchases. Mr. Ortiz believed that this reflected a reaction by some sellers to the external events occurring at that time, and was not related to the intrinsic value of the securities or to any underlying long-term change in the Fund market. Accordingly, the Desk responded with a combination of modest requests to increase inventory to bridge timing gaps between buyers and sellers, and, over the course of the next few months, approximately one-hundred targeted bid reductions. *See infra* Section II.C.3. Mr. Ortiz and his team sought thereby to find balanced demand without creating the misimpression that UBS' view of the intrinsic value of the Funds had dramatically changed, and without inadvertently generating a panic that might lead to a run on the Funds. UBS PR took other appropriate steps to determine demand, including educating FAs and customers about attractive features of certain Funds.

Because the commitment of capital to fund additional purchases of Fund shares into inventory required the approval of Mr. Michel (UBSFS' US Wealth Management Division's Chief Risk Officer), each time the Desk sought an exception to its $30 million operational limit, Mr. Ortiz (or Mr. Rosado) would draft a written request detailing the rationale for the proposed exception. Before presenting any such request to Market Risk, Mr. Ortiz would preview it with Mr. Ubinas (UBS PR's President and COO) and Mr. Belaval (his direct supervisor) to make sure

his superiors supported his decision and reasoning.[12] In this manner, every request for a temporary limit extension was fully vetted and subject to regular monitoring by Mr. Ortiz's superiors. In every request for Fund inventory limit extensions during this period, Mr. Ortiz and the Desk—supported by Messrs. Ubinas and Belaval and ultimately approved by Mr. Michel—described their belief that the Funds' structure and quality were sound, and that prices and yields remained attractive, such that a temporary availability of additional capital to facilitate trading would allow demand and supply to equalize in an orderly manner over time.[13]

Although the Division's Order paints this period—indeed, the entire period from mid-May 2008 through mid-March 2009—as one of steady and incessant inventory accumulation, empirical data tell a very different story. At its absolute peak, inventory reached $50 million, less than 1% of the Funds' overall market capitalization, a level consistent with UBS PR's historical risk appetite.[14] Throughout, there remained substantial demand for Fund shares—investors purchased *more than $330 million* worth of Fund shares between September 1, 2008 and March 19, 2009, a time period during which the Funds' inventory increased by only approximately *$20 million net*.[15] And there were times when it appeared that the balance between buyers and sellers was approaching equilibrium. In both November 2008 and January

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[12] *See generally* Tab 11 (August 21, 2007 email from C. Ortiz to C. Rosado ("We must talk to Geno [Belaval] and Carlos [Ubinas] before we send [inventory limit requests out] so that we have their support").

[13] *See* Tab 12 (September 5, 2008 request from C. Rosado to T. Magdziak cc'ing, B. Michel, C. Ortiz, et. al); Tab 13 (September 16, 2008 email from C. Rosado to T. Magdziak cc'ing C. Ortiz); Tab 14 (September 30, 2008 request from C. Rosado to T. Magdziak cc'ing C. Ortiz, et al.); Tab 15 (UBSPR-SEC-006-000949-50); Tab 16 (UBSPR-SEC-006-027080-81).

[14] *See* Tab 8 (June 2, 2008 email from T. Magdziak, Risk Officer) ("I would recommend approving the request as the overall position limit would still be les [sic] than 1% of all shares outstanding"). When the $30 million limit was first established, it amounted to approximately 1% of the total market capitalization of the Funds at the time. In subsequent years, with new offers, the market capitalization had grown from about $3 billion to more than $5 billion (but the inventory limit had remained at $30 million). Mr. Ortiz's view was that, due to the growth of the overall market, the baseline inventory limits should also have grown, maintaining that 1% relationship. Therefore, from Mr. Ortiz's perspective, an increase to $50 million in a market that had grown from $3 billion to $5 billion, was in line with the historic level of inventory authority used by the Desk.

[15] *See* Tab 17 (UBS PR Fund Customer Buy Volume and Change in Inventory, 9/1/08 – 3/19/09).

2009, buy volume outpaced sell volume, and aggregate Fund inventory levels dropped by approximately 10% before increasing again in comparable amounts the following month.[16]

C. March – April 2009

By mid-March 2009, the Funds appeared to Mr. Ortiz to again be approaching a turning point. On the one hand, inventory was at a level near $50 million, with more sell orders appearing likely in the short-term, potentially requiring a modest increase in inventory. On the other hand, there were promising signs: most prominently, investor concerns over the solvency of Puerto Rico's government (and thus many Fund assets) were addressed when rating agencies reaffirmed Puerto Rico's investment grade rating. Additionally, regulatory reforms lifted restrictions on Fund investments by Individual Retirement Accounts, creating a new and potentially substantial source of Fund demand. Taking account of these and other factors, Mr. Ortiz again planned a two-tiered strategy of bid reductions and inventory increases designed to locate a more stable equilibrium, and sent his supervisors and the Risk team a memo on March 19, 2009 outlining how he planned to proceed.[17]

The global financial crisis, however, had taken its toll on UBS' corporate willingness to put its own capital at risk. UBS lost $19 billion in the financial crisis, and reeling from those losses (and under a new management regime), embarked on a global effort to reduce risk. Mr. Ortiz's March 19 request for an inventory increase arrived in the middle of that global effort, and was rejected.[18]

Instead, Risk personnel indicated that Mr. Ortiz should work to revert to the standing $30 million level. Mr. Michel (Chief Risk Officer) believed that maintenance of a fund balance at

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16 Tab 18 (Monthly Customer Sell Volume and Buy Volume and Month-End Aggregate Inventory October 2008 – February 2009).

17 *See* Tab 16 (UBSPR-SEC-006-027080-81).

18 *See* Tab 19 (SEC Ex. 106).

that level would afford UBS PR sufficient flexibility to provide liquidity in the future should the need arise.[19]

Mr. Michel's decision coincided with positive developments affecting the Puerto Rico Municipal securities market, such as favorable responses from rating agencies to initiatives announced by the Puerto Rican government.[20] Over the next six weeks, customers bought nearly 11 million shares. This wave of investor demand—which Mr. Ortiz had forecasted would follow from the good news about Puerto Rico's credit rating—reduced inventory by nearly 20% from March 19 to March 31. By late April inventory levels were back under the historic $30 million level, below where they were on the eve of the Lehman crisis, and below where they had been a year prior, when Mr. Ortiz had made the first request for an increase in inventory purchases.[21]

D. May – August 2009

From Mr. Ortiz's perspective, the difficult challenges he had faced over the prior eight months seemed to have been brought to a satisfactory conclusion—supply and demand were again in relative balance, and inventory was back at historical levels.

One month later, however, senior management at UBSFS, the parent company of UBS PR, influenced by the global mandate to reduce risk, directed further severe inventory reductions within a short timeframe. In May 2009, the Risk Committee of UBSFS revised UBS PR's permanent Fund inventory limit from $30 million—its level since 2003—to $12 million.[22] The Risk Committee's decision was reached on the recommendation of Mr. Michel, UBSFS' Chief

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[19] *See id.*

[20] *See* Tab 16 (UBSPR-SEC-006-027080-81); Tab 20 (UBSPR-SEC-011-005623).

[21] *See* Tab 21 (UBSPR-SEC-019-001857) (April 28, 2009 email from C. Ortiz to M. Culnan cc'ing B. Michel reporting that the Desk opened with less that $30 million in inventory).

[22] *See* Tab 22 (May 29, 2009 email from C. Ortiz to B. Michel, C. Ubinas, J. Price and E. Belaval).

Risk Officer, without the input or inclusion of Mr. Ortiz.[23] Indeed, no one from UBS PR learned about the decision until after-the-fact.[24] Mr. Ortiz was instructed to comply with the reduction mandate within two months.[25]

Mr. Ortiz (and others within UBS PR) objected to this sudden reduction in inventory levels, which they believed threatened to leave the Trading Desk with diminished ability to supply meaningful liquidity to the more-than-$5 billion Fund market. Mr. Ortiz feared that FAs and customers would draw the conclusion that UBS was no longer willing to provide liquidity to the market, a result that threatened to expose investors to the very risk described in the Fund brochures and offering prospectuses—substantial challenges selling their investments and substantial price volatility. Mr. Ortiz raised these issues with the Risk Committee members directly—notwithstanding that several of them were four and five executive levels above him—and voiced his concern that the mandated reduction posed "potential destruction of investors' wealth in our market" and that it did not appear to have been "reached with the correct analysis, which I did not have a chance to comment on before its presentation at the RCC [Risk Control Committee]."[26] When informed that the decision was a *fait accompli*, he lobbied UBSFS senior executives for more flexibility and more time to achieve the inventory reduction directive, so as to minimize the risk of panic unrelated to the intrinsic value of the Funds.[27] He received some added flexibility, but not additional time.[28]

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23 *See id.*; *see also* Tab 23 (May 29, 2009 email from C. Ortiz to B. Michel, C. Ubinas, and E. Belaval noting "I was not aware that a decision of this magnitude had been reached by the RCC, especially without gicing [*sic*] the business managers a chance to react").

24 *See* Tab 24 (SEC Ex. 78).

25 *See* Tab 22; *see also* Tab 23.

26 *See* Tab 22.

27 *See* Tab 25 (SEC Ex. 88); *see also* Tab 26 (June 17, 2009 email from C. Ortiz to M. Bernd); *see also* Tab 27 (UBSPR-SEC-021-015434-35).

28 *See* Tab 25 (SEC Ex. 88) at UBSPR-SEC-023-000173.

Regulatory rules on order priority and internal Firm policies forbade Mr. Ortiz from selling inventory ahead of a customer offer to sell at the same price.[29] This meant that to meet the schedule the Risk Committee required, the Desk from time to time needed to lower the price it was willing to accept for Fund inventory below that of the lowest pending customer offer to sell the same Fund.

Mr. Ortiz disclosed this fact to his direct supervisors and to members of the Risk Committee who were overseeing the implementation of the inventory reduction mandate.[30] He also inquired of senior management at both UBSFS and UBS PR as to whether further disclosure to investors was warranted or required. In frank terms, Mr. Ortiz told them: **"I believe we should consult Legal-Compliance on the need to clearly inform the market of our change in practice regarding funds trading."**[31] Others made the good faith judgment that existing disclosures were sufficient. As the June 2009 Wealth management Risk Report explains:

> Legal & Compliance have further completed an analysis of relevant disclosure documents and educational materials for FAs. It was concluded that disclosures adequately reflect risks for investors and explain UBS's obligations as a liquidity provider. The educational material sufficiently explains the product and its risks to FAs.[32]

Having raised his concerns directly, which were then addressed by senior management, Mr. Ortiz carried out the inventory reduction mandate on the schedule set for him, reducing inventory to $12 million by late July 2009.

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[29] *See E.F. Hutton & Co.*, Exchange Act Release No. 25887, 41 SEC Docket 413, 1988 WL 901859, at *3 (July 6, 1988) (the "*Manning*" decision). The Commission's decision in *Manning*, affirming the sanction of a broker-dealer for executing proprietary trades at prices equal to or greater than an unexecuted customer limit order without disclosing the consequent conflict of interest has been codified in formal NASD Guidance. *See* Trading Ahead of Customer Limit Order, NASD IM-2110-2 (2009). The Desk's Trading Guidelines memorialized, and mandated compliance with, its *Manning* obligations. *See* Tab 4 at UBSPR-SEC-006-001313 ("NASD Rules forbid the Trading Desk, when it accepts and holds a customer's market order or limit order, from trading for its own account at prices that would satisfy the market or limit order, unless it immediately thereafter executes the order").

[30] *See* Tab 25 (SEC Ex. 88), at UBUSPR-SEC-023-000174 ("In terms of reducing the funds inventory, we are . . . [l]owering our price to keep ahead of any client open orders in terms of the lowest offer price in the market").

[31] *See* Tab 26 (UBSPR-SEC-045-018812) (emphasis added).

[32] *See* Tab 28 (UBSPR-SEC-020-000021-40, at UBSPR-SEC-020-000032-33).

ARGUMENT

I. LEGAL STANDARDS

The Division asserts that Mr. Ortiz made, aided and abetted, or caused material misrepresentations concerning Fund pricing practices and Fund liquidity and manipulated, or aided and abetted or caused the manipulation, of Fund prices.

To prevail on its misrepresentation theories, "the Division must establish that [Mr. Ortiz] made material misrepresentations or materially misleading omissions in connection with the offer, sale or purchase of securities, either acting with scienter or negligently." *In the Matter of John P. Flannery & James P. Hopkins*, Exchange Act. Rel. No. 438, 2011 WL 5130058, at *32 (Oct. 28, 2011). To the extent the Division alleges omissions, the Division must demonstrate that Mr. Ortiz had an independent duty to disclose the information purportedly omitted. *Basic Inc. v. Levinson*, 485 U.S. 224, 239 n.17 (1985). To impose primary liability on Mr. Ortiz for the alleged misstatements, the Division also must show that Mr. Ortiz had "ultimate authority and control" over the alleged misstatements at issue. *Flannery*, at *34 (citing *Janus Capital Grp., Inc. v. First Derivative Traders*, 131 S. Ct. 2296 (2011)).

Market manipulation is "virtually a term of art when used in connection with securities markets." *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 199 (1976). The term "refers generally to practices, such as wash sales, matched orders, or rigged prices, that are intended to mislead investors by artificially affecting market activity." *Santa Fe Indus., Inc. v. Green*, 430 U.S. 462, 476 (1977). The Commission has defined manipulation as "the deceptive movement of a security's price, accomplished by an intentional interference with the forces of supply and demand." *In the Matter of Patten Secs. Corp.*, Admin. Proc. File No. 3-7010, 51 S.E.C. 568, 572 (July 12, 1993). Whether asserted under Section 17 of the Securities Act or Section 10 of the Exchange Act, the Division's manipulation claims require a demonstration of scienter. *In the*

Matter of H.J. Meyers & Co., Exchange Act Rel. No. 211, 78 SEC Docket 718, 2002 WL 1828078, at *31 (Aug. 9, 2002) ("a showing of negligence sufficient to sustain a charge under Section 17(a)(2) or Section 17(a)(3) of the Securities Act is not enough to prove price manipulation"). To prevail on its manipulation claim, the Division must show that Mr. Ortiz deliberately "engaged in market activity aimed at deceiving investors as to how other market participants have valued a security." *ATSI Commc'ns v. Shaar Fund, Ltd.*, 493 F.3d 87, 100 (2d Cir. 2007).[33]

Maintenance of a substantial, or even dominant market position in a security does not, by itself, establish manipulation. *In the Matter of Pagel, Inc.*, Exchange Act Rel. No. 22280, 33 SEC Docket 1003, 1985 WL 548387, at *2 (Aug. 1, 1985). To establish liability on the basis of a manipulation theory, the Division must show that Mr. Ortiz abused UBS PR's market position by deliberately setting Fund prices at arbitrary levels. *Id; see also In the Matter of Robert J. Setteducati*, Exchange Act Rel. No. 8334, 81 SEC Docket 1723, 2003 WL 22570689, at *6 (Nov. 7, 2003) (enforcement proceedings were properly dismissed because no evidence demonstrated that the firm abused its market position by setting arbitrary prices). In other words, the Division must prove that Mr. Ortiz approved Fund bid and offer quotes which he knew bore "no relation to the merits of the investment." *See Collins v. United States*, 157 F.2d 409, 409-10 (9th Cir. 1946).

Proof of manipulation "almost always depends on inferences drawn from a mass of factual detail, including patterns of behavior, apparent irregularities, and trading data."

[33] To establish aiding and abetting liability, the Division must prove: "(1) the existence of a securities law violation by the primary (as opposed to the aiding and abetting) party; (2) 'knowledge' of this violation on the part of the aider and abettor; and (3) 'substantial assistance' by the aider and abettor in the achievement of the primary violation." *SEC v. Apuzzo*, 689 F.3d 204 (2d Cir. 2012). "Causing" liability requires proof of substantially the same degree of action as aiding and abetting (i.e., "substantial assistance") although the level of intent required to establish causing liability is commensurate with the underlying, substantive claim alleged. *See In the Matter of KPMG Peat Markwick, LLP*, Exchange Act Rel. No. 43, 862, 74 SEC Docket 384, 2001 WL 34138819 (Jan. 19, 2001).

Setteducati, 2003 WL 22570689, at *4 (quoting *Pagel, Inc.*, 48 S.E.C. 223, 226 (1985)) (internal punctuation omitted). While the presence or absence of any particular factor is not dispositive of a manipulation claim, the Commission has identified the following as "classic factors," indicative of manipulative activity: (1) a rapid surge in price, despite (2) scant investor demand; (3) the absence of any known, favorable prospects for the security at issue; and (4) the collapse of the market price for a security upon the cessation of the allegedly manipulative activity. *See In the Matter of Jay Michael Fertman*, Admin. Proc. File No. 3-7728, 51 S.E.C. 843, 948 (1994); *see also In the Matter of H.J. Meyers & Co.,* 2002 WL 1828078, at *43.

II. MR. ORTIZ DID NOT MISUSE UBS PR'S FUND INVENTORY TO "PROP UP" FUND PRICES

A. UBS' Role as a Liquidity Provider Was Amply Disclosed

The Division alleges that investors were not informed that "any secondary market sales investors wanted to make depended largely on UBS PR's ability to solicit additional customers or its willingness to purchase shares into inventory." Order ¶ 3. In fact, abundant disclosures clearly described UBS PR's role in the Funds' secondary market and the risks to investors attendant to such a role. The primary marketing document for the Funds, the UBS Family of Funds Brochure, explains:

> While UBS Financial Services Incorporated of Puerto Rico currently intends to maintain a market in the shares, and has since 1995, it is under no obligation to do so. Therefore, there may be occasions when you may be unable to sell your fund shares or may be able to sell them only at a loss or at times at a significant loss.[34]

The Funds Brochure further disclosed that "[a]fter the initial trading . . . the fund shares of the UBS Puerto Rico closed-end funds are traded through the trading desk of UBS Financial

[34] Tab 29 at 3 (SEC Ex. 13). The Funds Brochure was available on the UBS PR Funds website.

Services Incorporated of Puerto Rico . . . [which] . . . is the principal secondary market dealer for the UBS Puerto Rico closed-end funds."[35]

Similarly, the Funds' prospectus explains:

> UBS Puerto Rico currently intends to maintain a market in the Shares, although it is not obligated to do so, and may discontinue such activities at any time. No assurance can be given as to the liquidity of the market for the Shares as a result of such activities by UBS Puerto Rico. If UBS Puerto Rico's activities are discontinued at any time, there may be no other market for the Shares.[36]

Consistent with the potential liquidity risk, UBS PR markets the Funds as long-term investments that investors should plan to hold for significant time periods. In fact, the Funds' prospectuses make this point in the section regarding the liquidity risks related to the Funds:

> [T]he Shares [of the Funds] may not be suitable to all investors as they are designed primarily for long-term investors, and investors in the Shares should not view the Fund as a vehicle for trading purposes.[37]

Disclosure of these risks is also featured in the training materials used to educate UBS PR FAs. These materials highlight the liquidity risks of the Funds and the importance of determining if the Funds or any other product the FA recommends are suitable for that particular investor.[38]

These cumulative disclosures, while not drafted or approved by Mr. Ortiz, were fully vetted in a process that included counsel. Indeed, in the Spring of 2009, Legal and Compliance personnel from UBS PR's parent specifically re-reviewed the Fund disclosures and concluded that they "adequately reflect risks for investors and explain UBS's obligations as a liquidity provider."[39]

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35 *Id.*

36 Tab 30 at 2 (SEC Ex. 14). This, or language to the same effect, has been included in each of the prospectuses for the Funds. A prospectus is provided to all investors who purchase Fund shares in the primary offering and is also available on the UBS Puerto Rico Funds website.

37 *Id.* at 8.

38 *See* Tab 31 (June 25, 2007 email from Frank Pluchino, a Compliance Officer, to UBS PR FAs attaching 2007 training slides).

39 Tab 28 at UBSPR-SEC-020-000033.

Thus, the Division's central foundation for its fraud claim—that UBS PR failed to disclose UBS PR's role as the Funds' principal liquidity provider (and that Mr. Ortiz is somehow responsible for any such omission)—is simply wrong as a matter of fact.

B. UBS PR Did Not Use Its Inventory To Mask A Fund Liquidity Crisis In 2008

The evidence will also refute the Division's theory that UBS PR's inventory use in 2008 was part of a nefarious plot to "mask" from the market an otherwise unknowable "liquidity crisis." Notably, the Division's allegations center on a period in mid-to-late 2008 and early 2009, coincident with a global financial crisis. During this time of extreme market stress, a broad range of securities experienced order imbalances, including Puerto Rico municipal securities, Puerto Rico bank securities, and the Funds at issue here. The Division's hindsight second-guessing of the legitimate, good faith and real-time response to the well-known market tumult of 2008 does not provide a viable foundation for the fraud charges here.

Stripped of inflammatory adjectives, the core of the Division's complaint is as follows: during a period of historic local and global economic turmoil, UBS PR allegedly plotted to purchase Fund shares into its own inventory to produce artificially inflated prices and thereafter unloaded those shares onto "unsuspecting" Fund investors on the cheap. In other words, the Division suggests that Mr. Ortiz deliberately manipulated the market for CEFs so that UBS PR either could sustain inflated prices indefinitely in a $5 billion market (using an inventory position that never exceeded 1% of that amount), or that it intended to *buy high and sell low*. Either theory is illogical at best, and neither is supported by the facts.[40] The Hearing will show that Mr. Ortiz did not have such an irrational intent, but instead at all times acted in good faith to maintain an orderly market in the Funds.

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[40] *See ECA & Local 134 IBEW Joint Pension Trust of Chicago v. JP Morgan Chase Co.*, 553 F.3d 187, 203 (2d Cir. 2009) (affirming dismissal of securities fraud claim for lack of scienter because "[i]t seems implausible to have . . . an intent to defraud Plaintiffs by losing vast sums of money").

1. A Market Facilitator's Good Faith Provision of Liquidity During Periods of Market Stress Is Not Fraudulent

During the market turmoil of 2008 and 2009, there were points in time when there were more customers looking to sell their fund shares than there were customers looking to buy those shares. On nearly one-hundred occasions during this period, Mr. Ortiz approved reductions in Fund bid prices in an effort to find the level at which supply and demand were in equilibrium. On other occasions, Mr. Ortiz sought and obtained authority to purchase additional shares into UBS PR's inventory to alleviate what appeared to him to be a temporary order imbalance, in order to allow the market time to come back into balance. Both of these strategies were perfectly legitimate and appropriate.

The Division does not challenge the propriety of lowering bid prices, but takes the view that inventory increases without corresponding price reductions somehow constitute fraudulent manipulation. That is just not so. The complained-of behavior is in fact *exactly* what a responsible liquidity provider is supposed to do when faced with periods of economic stress:

> During financial disruptions, market makers provide liquidity by absorbing external selling pressures. They buy when the pressure is large, accumulate inventories, and sell when the pressure alleviates.[41]

No less an authority than the SEC Chairman has endorsed this view.[42] Supporting a market in precisely the fashion that the SEC Chairman has urged surely cannot be fraudulent or negligent.

The charges here turn this practical notion of market responsibility on its head. According to the Division, instead of using best efforts to facilitate liquidity and maintain an orderly market during a period of severe market dislocation, UBS PR and Mr. Ortiz should have

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[41] Tab 32 (Pierre-Olivier Weill, *Leaning Against the Wind*, 74 Rev. Econ. Stud. 1329 (2007)) at 1329.

[42] Mary Schapiro, Chairman, U.S. S.E.C., Speech at the Economic Club of New York, *Strengthening Our Equity Market Structure* (Sept. 7, 2010) (asking, in the wake of the May 6, 2010 flash crash, "whether the firms that effectively act as market makers during normal times should have any obligation to support the market in reasonable ways in tough times"), *available at* http://www.sec.gov/news/speech/2010/spch090710mls.htm.

cut prices radically whenever there were fewer buyers than sellers at a particular moment, thus introducing violent price swings and enormous volatility into the market—which would have predictably, in turn, further scared off buyers, requiring (in the Division's view) further price cuts in an inexorable race to the bottom. This theory lacks any basis in law or in fact, and reflects a policy judgment that is both ill-considered and ill-conceived. The interests of investors would be poorly served if liquidity providers like UBS PR were required in times of stress to abandon markets that they previously undertook to facilitate. As Respondent's expert, former SEC chief economist Erik Sirri, explains in his report: "pursuing an absolute equilibrium between buyers and sellers at all times rather than using inventory to facilitate liquidity . . . could lead to price volatility unrelated to the intrinsic value of the securities, a result that would serve investors poorly."[43] And the notion that UBS PR (let alone Mr. Ortiz) committed fraud by trying to maintain an orderly market by providing liquidity to Fund investors when that support was most crucial is untenable.

2. UBS PR's Use Of Inventory Was Modest And Consistent With Its Past Practices

The evidence will also refute the Division's foundational premise that UBS PR was effectively the only buyer in the market, creating the illusion through its inventory purchases of demand at the prevailing price when none in fact existed. In fact, the amount of Fund shares authorized for purchase into inventory over the relevant period was quite modest—both in absolute terms and in proportion to the market—and entirely consistent with UBS PR's historical risk appetite. *See supra* p. 12. And trading data will show that customer buy volume outpaced UBS PR's inventory purchases during this period by several multiples (frequently on the order of

[43] Tab 1 (Sirri Report) at ¶ 53.

twenty-five to one), demonstrating that substantial independent customer volume existed irrespective of the modest overall growth in UBS PR's inventory from market facilitation.[44]

The Division's assertions to the contrary rely on mischaracterization—or disregard—of empirical inventory and trading data. The Division's portrayal of the entire May 2008 - March 2009 period as one marked purely by UBS PR's steady and constant inventory accumulation is just not borne out by the facts. Rather, the data will show that Fund inventory levels gyrated continuously throughout the period in question on a routine—indeed daily—basis, which is consistent with a functioning OTC market. *See supra* p. 12-13.

For instance, the Division's Order claims that (1) UBS PR Fund inventory levels had reached \$37 million—\$7 million above its limit[45]—by the middle of May 2008; (2) notwithstanding the Trading Desk's alleged non-compliance with operational limits, Mr. Ortiz "continued to ask UBSFS for increased inventory limits;" and (3) "UBS PR's CEF inventory grew from May through August 2008." Order ¶¶ 28-30. This is just wrong. As noted above, Fund inventory did not "grow" from May to August 2008—it shrunk. Fund inventory levels receded beneath their pre-existing \$30 million limit by the end of the August 2008.[46] On September 2, 2008, more than four months into the period when UBS PR was supposedly expanding inventory to prop up prices, the overall amount of inventory was more than 10% *lower* than it was at the beginning of that period.[47]

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[44] *Id.* at ¶ 44.

[45] The Division's allegation in this regard is inaccurate. Market Risk had approved a temporary limit extension to \$40 million weeks prior. The Desk's \$37 million inventory position was well within that authorized limit. *See* Tab 5 (SEC Ex. 156).

[46] *See* Tab 9 (August 29, 2008 email from C. Rosado to T. Magdziak, et al.). The restoration of market stability and the resurgence of secondary market demand for the Funds in August 2008 was precisely the outcome that Mr. Ortiz predicted when he initially requested a temporary increase in inventory limits from his superiors two months prior. *See supra* p. 10.

[47] Tab 33 (Monthly Customer Sell Volume and Buy Volume and Month-End Aggregate Inventory May 1, 2008 – August 31, 2008).

As Professor Erik Sirri will testify, the oscillating pattern of UBS PR's inventory levels during this period is even more pronounced when reviewed (as Mr. Ortiz did) on a fund-specific and real-time basis.[48] Inventory levels for 7 of the 23 Funds, in fact, decreased between May 2008 and March 2009, which is flatly inconsistent with the Division's broad contention that the period was marked solely by large Fund accumulations by UBS PR.[49] Moreover, relevant evidence demonstrates substantial inventory fluctuation even in Funds for which overall inventory amounts increased during this period.[50] That could only happen if there was real customer demand.

The Division's Order chooses to disregard entirely the ebb-and-flow pattern of Fund inventory levels during this timeframe. By broadly alleging invariable inventory accumulation, the Division attempts to impose a pattern on the facts that does not exist.

3. Mr. Ortiz Was Fully Transparent Regarding UBS PR's Inventory Positions During the Alleged Inflationary Period

Mr. Ortiz regularly provided appropriate and accurate disclosures about inventory levels both to Financial Advisors and to his superiors. As to FAs, at Mr. Ortiz's initiative, and under his supervision, the Desk disseminated inventory sheets to Financial Advisors on a daily basis. Those sheets provided FAs with daily updates reflecting the Desk's inventory position as to each Fund,[51] each Fund's current bid/offer price, and which bids were firm and which were

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[48] Tab 1 (Sirri Report) at ¶ 47 ("rather than resulting from a smooth monotonic pattern of consistent daily increases, inventory accumulation occurred over a period of time that was punctuated by reductions in inventory levels").

[49] Tab 1 (Sirri Report) at ¶ 45; Tab 2 (Sirri Rebuttal Report) at ¶ 43.

[50] Tab 1 (Sirri Report) at ¶ 47.

[51] Until the beginning of September 2008, the inventory sheets the Desk circulated to FAs provided the precise amount of inventory, down to the individual share. Beginning in early October, the inventory sheets provided rounded figures, showing the general level but not the exact amount of inventory held. During the transition between these two versions of the inventory sheets, there was one week where the inventory sheets indicated whether there were at least 25,000 shares in inventory (which was enough to tell FAs whether there was sufficient supply in inventory to meet demand up to nearly a quarter of a million dollars) and a few more weeks where the inventory sheets indicated whether there were at least 50,000 shares in inventory (enough to support an order of nearly $500,000).

indicative.[52] Indeed, evidence will demonstrate that the Desk's allowance of Financial Advisor visibility into its inventory position exceeded norms of industry custom and practice, and provided a measure of transparency above and beyond that typically available in an OTC market.[53]

As to his supervisors, as noted above, every time the Desk sought an inventory extension, Mr. Ortiz (or another Desk Trader) provided his superiors—both at UBS PR and UBSFS—with a memorandum detailing the rationale for the request. These limit extension requests during the alleged imbalance period from mid-2008 through early-2009 refute any notion that Mr. Ortiz, or anyone else at UBS PR, questioned the underlying credit quality or structure of the Funds themselves. In each, Mr. Ortiz (or Mr. Rosado) expressed the view that any excess supply (or reduced demand) in the secondary fund market was caused by various temporary market forces external to the Funds that were likely to resolve themselves in the near-term. *See supra* p. 12. While Mr. Ortiz was not always perfect in predicting the future behavior of the market, no evidence will call into question Mr. Ortiz's good faith and sincere belief, *at the time of the requests*, of the views expressed in the limit extension requests. Mr. Ortiz shared these views freely and openly with the highest levels of UBS PR management (who supported them) and UBSFS' Chief Risk Officer (who approved them). Mr. Ortiz's candor with his superiors in requesting these temporary inventory limit extensions is totally incompatible with the notion that he was illicitly employing such extensions to further a fraudulent scheme.

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[52] A firm bid commits the Desk to buy or sell the amount of shares quoted at the price quoted. An indicative bid reflects the Desk's judgment of the market, but does not commit the Desk to purchase or sell any specific amount the quoted price. Trading data confirms, however, that the Desk and customers traded at the bids and offers it quoted, even when its bids were indicative. *See* Tab 1 (Sirri Report) at ¶ 57.

[53] Additionally, the Desk would immediately send FAs updated inventory sheets reflecting revised bid and offer prices every time the Desk changed its quotes. Simultaneously, upon each price change, the Desk would also notify UBS PR's pricing department by email.

C. Neither Mr. Ortiz Nor UBS PR Manipulated Fund Prices During the Alleged Inflationary Period

The Division's theory that, between May 2008 and March 2009, the Desk and Mr. Ortiz artificially inflated Fund prices to levels beyond those investors were willing to pay similarly fails as a matter of logic and fact. Instead, the evidence will demonstrate that (1) UBS PR's processes for setting its price quotes for the Funds were reasonable; (2) UBS PR's role and processes in Fund price discovery were adequately disclosed both to FAs and to investors; and (3) UBS PR continuously assessed market circumstances and changed price quotes as appropriate. Moreover, none of the rationales advanced by the Division alleging that Fund prices were wrong withstand scrutiny.

1. Under Mr. Ortiz's Direction, The Trading Desk Followed Reasonable, Disciplined And Established Price Quoting Processes At All Times

The allegation that UBS PR manipulated Fund prices rests on the demonstrably false premise that the Desk "had no substantive written or formal CEF pricing procedures or guidelines" during 2008 and 2009. OIP ¶ 22. As described above, UBS PR had, in fact, developed and established detailed trading guidelines, implemented long before the period in question.[54] Under these guidelines, Desk employees were expected to, and did, exercise their best judgment taking into account various market forces. Market factors the Desk considered included various indicators and variables of supply and demand, including trading volume, inventory levels, the size and price of current open limit orders, yields relative to competing instruments or securities on the market, the anticipated future supply of competing investments, and more general, global, national and local macroeconomic and market conditions. *See supra* p. 7-8. Consistent with these guidelines, the evidence will show that the Trading Desk

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[54] *See supra* pp. 7-8.

employed a dynamic and diligent price discovery process for the Funds before, during, and after the period in question.

The record will demonstrate that Messrs. Rosado, Prats and Ortiz adhered to this independent process throughout 2008 and into early 2009, and quoted the Funds in good faith and based on their best judgment as to the dictates of then-existing market conditions. The Desk's exercise of independent and good faith judgment, and due consideration of the various factors enumerated in the Trading Guidelines, is evident from the documentary record and will be made plain at trial. Each of the Desk's requests for inventory limit extensions during this period—directed to and approved by UBSFS' Head of Risk and various other of Mr. Ortiz's supervisors—elaborate on the Desk's rationale for the prices it quoted in the Fund secondary market.[55] These explanations—the principal contemporaneous evidence detailing the Desk's pricing rationale—show that Mr. Ortiz and the Traders on the Desk assessed Fund prices, and believed their quotes were reasonable, in light of order balances, the yields and performance of competitive or comparable instruments, and general market factors (both local and global), among other things.

Notably, in 2009, senior executives at UBSFS undertook an internal review of UBSPR's fund pricing during the period in question. In the course of this review, they examined, with Mr. Ortiz's full cooperation, the Desk's pricing practices and its historical price quotes during and through the global credit crisis.[56] And no one no one concluded that Fund prices were irrational, arbitrary or quoted in bad faith.

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[55] *See, e.g.*, Tab 5 (SEC Ex. 156); Tab 12 (September 5, 2008 request from C. Rosado to T. Magdziak cc'ing, B. Michel, C. Ortiz, et. al.); Tab 13 (September 16, 2008 email from C. Rosado to T. Magdziak cc'ing C. Ortiz); Tab 14 (September 30, request from C. Rosado to T. Magdziak cc'ing C. Ortiz, et al.); Tab 15 (UBSPR-SEC-006-000949-50); Tab 16 (UBSPR-SEC-006-027080-81).

[56] *See, e.g.*,Tab 34 (May 19, 2009 email from C. Ortiz to C. Ubinas cc'ing E. Belaval); *see also* Tab 35 (May 17, 2009 email from C. Ubinas to J. Price).

The Desk's careful adherence to reasonable and established guidelines in making its pricing determinations during the relevant period negates any inference that price quotes it generated were arbitrary.

2. UBS PR's Fund Price Discovery Processes Were Reasonably And Accurately Disclosed

That the Trading Desk exercised its informed judgment to quote bid and offer prices that would reasonably reflect market conditions and foster liquidity in the secondary market for the Funds was amply disclosed. Both the Funds Brochure and the prospectuses described the Fund pricing process as a judgment-based methodology that involved assessing the relative significance of various market indicators of supply and demand, among other factors. Specifically, the Funds Brochure states that the Trading Desk uses "market factors such as supply and demand and the yield of similar types of products [to] determine the price of the closed-end fund shares."[57] Fund prospectuses similarly state that "[t]he market price of the Shares will be determined by such factors as relative demand for and supply of the Shares in the market, general economic and market conditions, and other factors beyond the control of the Funds."[58]

These disclosures make clear the discretion afforded the Trading Desk's price discovery process. No fair reading of them could lead one to conclude that isolated snapshots of "supply and demand"—which the Division seemingly interprets to contemplate the immediate matching of customer buy and sell orders—alone would determine prices.[59]

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[57] Tab 29 at 3 (SEC Ex. 13).

[58] Tab 30 at 8 (SEC Ex. 14).

[59] Moreover, even assuming UBS PR's disclosures regarding the pricing process were misleading or inaccurate—which they are not—Mr. Ortiz should not be faulted for such failings. Mr. Ortiz had absolutely no responsibility for or involvement in the Firm's various public disclosures regarding the Funds and the Division will not be able to contend otherwise.

Evidence at trial will further demonstrate that Mr. Ortiz consistently explored and advocated for ways to introduce even more visibility into UBS PR's pricing processes. At Mr. Ortiz's urging, the Desk formalized dissemination of, and enhanced information contained in, Fund inventory sheets (reflecting, among other things, inventory available in each Fund, bid and offer prices for each Fund, and whether the prices quoted by the Desk were firm or indicative), and the Good-til-Cancelled ("GTC") book (publicizing to FAs on a daily basis open orders on the buy or sell side).[60] Mr. Ortiz's transparency with respect to Fund pricing negates any inference of manipulative intent.

Deception is the *sine qua non* of market manipulation.[61] Accordingly, "[i]n order for market activity to be manipulative, that conduct must involve misrepresentation or nondisclosure."[62] None exist here. The Funds' brochure and prospectuses, available on the Firm's website, disclosed that pricing was based on the Trading Desk's assessment of various market factors (also described in the Trading Guidelines), of which current order equilibrium was but one. Mr. Ortiz cannot now be labeled a manipulator for doing precisely what the disclosures contemplated he would.[63] The mere fact that the Division would now ascribe more weight to its interpretation of one factor (*e.g.*, supply and demand) than another closely-related

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[60] The GTC Book was a list of all open marketable orders maintained by the Trading Desk. At Mr. Ortiz's initiative, the Desk began providing the GTC book to the FAs in February 2009, more than seven months after Mr. Ortiz first requested to publish the information to the FAs (such publication was subject to appropriate review by Firm Legal and Compliance). Mr. Ortiz believed that publication of the GTC Book would enhance transparency of order flow to the FAs, which in turn would provide customers the opportunity to react to other customers' orders, and seek out liquidity at prices away from the Desk's quotes.

[61] *See Wilson v. Merrill Lynch & Co.*, 671 F.3d 120, 130 (2d Cir. 2011) ("The gravamen of manipulation is deception of investors into believing that prices at which they purchase and sell securities are determined by the natural interplay of supply and demand, not rigged by manipulators") (internal citation and quotation marks omitted).

[62] *Id.*

[63] *Id.* at 132-33 (affirming dismissal of manipulation claim where the alleged manipulative activity was fully disclosed in documents available on firm website).

factor (*e.g.*, yields of comparable instruments) does not mean that Mr. Ortiz manipulated the price or committed fraud by not assessing these factors the same way.[64]

3. The Desk Did Not "Refuse" To Reduce Prices.

The Division's claims that Mr. Ortiz manipulated Fund prices by refusing to reduce prices in the face of diminishing demand fails additionally for a more simple reason—*the Desk did reduce prices*. In direct contrast to the Division's theory, in the ten month period in question (May 2008 through February 2009), the Desk reduced Fund prices 91 times.[65] By way of comparison, during the preceding ten months (from July 2007 through April 2008), the Trading Desk lowered Fund prices 20 times.[66] In other words, the Desk decreased its price quotes for the Funds more than four times as often in the alleged Inflationary Period than it had in the comparable, prior period. UBS did not "refuse" to lower prices; it pursued a dual strategy: lowering bid quotes to find demand, while at the same time (with Risk's approval) extending modest, additional amounts of capital to provide liquidity in a period of episodic excess supply. This is entirely consistent with notions of fair pricing by a responsible market facilitator.

Indeed, contrary to the notion that it was "propping up" prices, by October 2008, the Desk was emphasizing that, to address what they perceived as "a temporary supply and demand imbalance" in the Funds secondary market, it would "buy when we see buy side demand at

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[64] *See Fraternity Fund Ltd. v. Beacon Hill Asset Mgmt.,* 479 F. Supp. 2d 349, 363 (S.D.N.Y. 2007) (dismissing securities fraud claim: where fund prospectus disclosed that valuation would entail the exercise of manager's judgment, a securities fraud claim premised on mispricing must demonstrate "not [that] the values were 'wrong' in some empirical sense, but [that] . . . management did not give its honest opinion"); *In re Allied Capital Corp. Sec. Litig.*, No. 02 Civ. 3812(GEL), 2003 WL 1964184, at *4 (S.D.N.Y. Apr. 25, 2003) (dismissing price manipulation claim: "Even when plaintiffs provide a reason that an investment's value should have been reduced . . . they do not explain why that factor should have been accorded significance, or allege that [Defendant's] policy did not take that factor into account"); *In the Matter of H.J. Meyers & Co.*, Exchange Act Rel. No. 211, 78 SEC Docket 718, 2002 WL 1828078, at *40 (Aug. 9, 2002) (dismissing proceeding premised on upward manipulation claim: "The OIP alleges that [Respondent] . . . sold at 'excessive' and 'inflated' prices . . . [and that] . . . the price of [the security] 'remained high' throughout the manipulative period. The issue for decision is: excessive, inflated and high, relative to what? The Division has no theory as to the maximum non-manipulated price").

[65] Tab 36 (Frequency of Downward Bid Revisions).

[66] *Id.*

whatever prices clear the market," and advised FAs to "manage client expectations," accordingly.[67] As bid quote reductions accelerated near and through year-end, FAs lodged numerous and strenuous complaints that the Desk was reducing prices too quickly and too severely—directly in the middle of the period in which the Division complains prices were artificially propped up and the Desk was "refusing" to lower prices. In part to respond to growing sales force dissatisfaction over increasing bid reductions, on January 21, 2009, Mr. Ortiz made a presentation to the sales force in which he explained succinctly that "[p]rices have dropped due to a supply and demand imbalance."[68]

At bottom, when placed in appropriate context, the Division's mispricing theory hinges on its bare hindsight conviction that the Desk should have reduced its bids more quickly than it did. Mere disagreement with the Desk's assessment—or the notion that (with the benefit of hindsight) the Division would have quoted bids for the Funds differently than the Desk did—is not a valid basis for a fraud charge,[69] and certainly not a justifiable ground to end Mr. Ortiz's professional life.

4. The Division's Alternative Theories of Mispricing Do Not Withstand Scrutiny

The Division advances three rationales why the Funds were overpriced during the period: that (1) Fund prices did not parallel the net asset value (NAV) of their constituent holdings (¶¶ 22, 33); (2) UBS PR's steady increases in Fund inventory should have prompted more or sharper downward bid revisions (¶¶ 28-32); and (3) yields for the Funds were maintained at or

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[67] Tab 37 (October 16, 2008 email from M. Perez to C. Ortiz, et al. attaching "Key Messages Closed-End Funds.ppt").

[68] Tab 38 (January 21, 2009 email from M. Pascual to several FAs attaching slides from Mr. Ortiz's presentation that same day to FAs regarding the PR Bond Funds).

[69] *See Bangor Punta Corp. v. Chris-Craft Indus., Inc.*, 337 F. Supp. 1147, 1153-54 (S.D.N.Y. 1971) ("The charge that in disposing of [their] holdings, the institutions acted to produce the least possible disturbance of price does no more than charge the institutions with ordinary prudence in their management of their affairs"), *aff'd*, 480 F.2d 341 (2d Cir. 1973).

above comparable closed-end funds (¶ 33). None of these hypotheses are persuasive or supported by the evidence.

a. The Variation between the Funds' Price Quotes and Their NAV Does Not Suggest Mispricing

The Division's position that the Funds must have been mispriced during Phase I because their prices did not closely track the NAV of their portfolio holdings flouts generally accepted finance theory, and ignores both the Funds' characteristics and their disclosures.

First, as Professor Sirri will explain, it is a well-understood and generally accepted principle in finance that closed-end funds often trade at prices away from their NAVs and that these variances are often unpredictable and difficult to explain. For over 30 years academic researchers have attempted to solve what has come to be called "the closed-end funds puzzle"—*i.e.*, why is it that the prices at which CEFs sell often differ from their per share NAVs?[70] While this research has documented a number of factors that affect CEF pricing, no theory has yet been developed that fully accounts for the range of price-NAV relationships observed in the marketplace. One outcome that is clear from this extensive body of research, however, is that the question is very complex. As such, periodic fluctuations above (or below) some baseline premium are not unusual, much less inherently suggestive of some artificial interference with the forces of supply and demand. Accordingly, the fact that UBS PR CEFs traded at premiums to NAV and that premiums for certain of the Funds widened at times is not proof that Fund price quotes were deficient.[71] Indeed, both before and after the period of alleged manipulation, the Funds have traded at premiums.

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[70] They have examined numerous potential explanations, including for example: whether there are factors that lead net asset values to be miscalculated; whether CEF prices are affected by shareholders' tax liability; whether investor desire for high dividend yields drives the demand for CEFs; whether the price-NAV relationship differs for different types of CEFs (e.g., bond vs. equity vs. country funds); as well as a host of other hypotheses. Plaintiff's own expert has acknowledged the uncertainty in finance literature on this point.

[71] Tab 1 (Sirri Report) at ¶ 33; Tab 2 (Sirri Rebuttal Report) at ¶ 9.

Second, the PR CEFs in particular have characteristics that would tend to support premiums to their NAV. Among other things, the Funds offer (1) substantial tax advantages to investors that would be otherwise unavailable to an investor seeking to invest directly in Fund assets; (2) the option to invest through private placements in Puerto Rico securities that are not available to retail investors; (3) access to a highly successful asset management team that had successfully structured more than 20 CEFs over a 15-year period (totaling more than $5 billion) without a single missed dividend payment, even during the most difficult period of the Financial Crisis (when many UBS CEF dividends actually *increased* due to lowered borrowing costs); and (4) the ability to leverage themselves at a lower cost of borrowing than would be available to many Puerto Rico retail investors. These tax and leverage features, among others, make the Funds inherently more valuable to retail investors in Puerto Rico than the sum of the assets they hold. And given these features, that the Funds traded at a premium to NAV is not surprising, and certainly not suggestive of fraud.[72]

Third, Fund disclosures explicitly told investors that NAV was not a principal driver of Fund pricing. The Funds Brochure explained that Fund prices are "determined by how much buyers are willing to pay or sellers are willing to accept and how the fund is performing compared to similar investments, *and not primarily by the NAV of the Fund's holdings*."[73] The Funds' prospectuses likewise observed that Funds tended to "trade[] at a price equal to or greater than their net asset value . . . in part because the market price of the Shares reflects the dividend yield on the Shares."[74] They further cautioned that "[w]hen the yield on the net asset value per Share is higher than yields generally available in the market for comparable securities, the

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[72] Tab 1 (Sirri Report) at ¶ 33; Tab 2 (Sirri Rebuttal Report) at ¶¶ 13-21 & Ex. 24.

[73] Tab 29 at 3 (SEC Ex. 13).

[74] Tab 30 at 8 (SEC Ex. 14).

market price will tend to reflect this by trading higher than the net asset value per share to adjust the yield to a comparable market rate."[75] That the Division alleges Mr. Ortiz committed fraud by not pricing these shares in line with a factor that investors were expressly told was *not a primary driver of Fund pricing* shows just how far the Division's charges depart from fairness and common sense.

b. UBS PR's Fund Inventory Levels Do Not Suggest Mispricing

The Division bases its suggestion that inventory movements required more significant price reductions on the flawed presumption that UBS PR's inventory accumulation during Phase I was steady and constant. The Division's premise is contradicted by facts in their possession at the time of the Order.

Indeed, the examples the Division highlights in its Order to illustrate inappropriate price stability—presumably selected as those that best fit its strained theory—only underscore the theory's flaws. The Division misleadingly contends that Mr. Ortiz should have reduced the price of Fixed Income Fund I between May and August 2008 because UBS PR held "$5.7 million shares of that fund in inventory" at that time. OIP ¶ 31. But UBS PR did not consistently hold $5.7 million shares of that Fund in its inventory during that period.[76] The number cited by the Division only represents the peak inventory level, which UBS PR held only briefly.[77] By August 2008—with Fixed Income Fund I shares remaining constant at the price that the Division now contends was artificially inflated—UBS' inventory position in that Fund had dropped to less than two thousand shares (or about $20,000).[78] This means that by August 2008, buyers in the secondary market had been willing to purchase 99.6% of Fixed Income Fund I shares UBS PR

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75 *Id.*

76 Tab 1 (Sirri Report) at Ex. 10.

77 *Id.* at Ex. 1.

78 *Id.* at ¶ 48.

held in its inventory at the very price UBS PR quoted from May to August. The suggestion that Mr. Ortiz should have lowered the Fund's price in the face of this demonstrable customer demand at the price quoted—but here challenged—is nonsense.

Similarly, the Division faults Mr. Ortiz for failing to lower more sharply the price of Fixed Income Fund IV between May and December 2008, notwithstanding purportedly increasing inventory positions in this Fund. *See* OIP ¶ 32. Again, the facts do not support the Division's theory. UBS PR's inventory in this Fund did not rise steadily or consistently between May and December 2008. Indeed, at various points in this period, UBS PR sold *all* of its Fixed Income Fund IV shares out of its inventory, requiring it to accumulate shares to meet anticipated future demand.[79]

These examples, and many others, demonstrate that secondary market demand persisted at the prices UBS PR quoted, that UBS PR's inventories fluctuated, and that the Division's theory that UBS PR was the only buyer in the market at the prices it quoted, or that it "propped up" its prices through inventory purchases, is flat wrong.

c. That the Funds' Yields Were in Line with Yields of Comparable Instruments Does Not Suggest Mispricing—It Confirms the Opposite

Finally, the Division's position that the Funds must have been mispriced because they exhibited yields that were similar to comparable instruments makes no sense. Hearing evidence will validate the understanding—held by almost everyone who has studied or participated in the Puerto Rican market—that the Puerto Rican fixed income market trades principally on yield. In such a market, yields of alternative or competitive instruments provide significant insight into supply and demand for the Funds themselves. Put differently, if competing instruments offer more attractive yields, demand for the Funds is likely to be low until either Fund yields increase

[79] *Id.* at Ex. 9.

(either through a price decrease or dividend increase) or the yields of comparable instruments decline. It is no more "manipulation" to price the Funds so their yields are similar to comparable instruments than it is "manipulation" to meet a competitor's price in the marketplace.

Furthermore, UBS PR's Trading Guidelines expressly contemplated that the Desk would consider "yield and current yield figures of similar securities" in their pricing processes. Fund disclosures made this fact plain. *See, e.g.*, Funds Brochure (Tab 29), at 2 (SEC Ex. 13) ("Market factors such as supply and demand and the yield of similar types of products determine the price of the closed-end fund shares"); Prospectus (Tab 30), at 8 (SEC Ex. 14) ("[w]hen the yield on the net asset value per Share is higher than yields generally available in the market for comparable securities, the market price will tend to reflect this by trading higher than the net asset value per share to adjust the yield to a comparable market rate"). Considering yields of comparable instruments was, then, objectively reasonable, and fully consistent with the market's expectations, the Firm's trading guidelines and the Funds' disclosures.

III. MR. ORTIZ DID NOT MAKE ANY MATERIAL MISSTATEMENTS

In a search for a false statement to support its fraud charge, the Division blames Mr. Ortiz because (a) a newspaper's weekly publication of Fund prices allegedly failed to disclose that the quotes published were indicative; and (b) customer account statements listed fund share prices as "market values." But Mr. Ortiz had no involvement in, much less responsibility for, either of these documents, which, in any event, were not materially misleading The only other alleged misstatements the Division identifies during this period—(c) the Desk's temporary revision of inventory sheets to reflect whether there was at least 25,000 or 50,000 shares in inventory for each Fund, as opposed to the exact level of inventory; and (d) Mr. Ortiz's brief remarks at a March 2009 Investor Conference—likewise do not support a securities fraud claim against Mr. Ortiz. The inventory sheets accurately disclosed the number of shares the Desk committed to

offer at the quoted price, and thus were not misleading. And Mr. Ortiz's short presentation at the Investor Conference (which was reviewed and approved by appropriate Legal and Compliance personnel, as well as various senior members of UBS PR) was accurate in all respects.

A. Prices Published in a Local Newspaper Are Not Actionable Misstatements

The Division's attempt to hold Mr. Ortiz liable for *El Vocero*'s publication of Fund prices is absurd. Mr. Ortiz played virtually no part in the provision of price information to *El Vocero*. Rather, the practice—including the type of price information provided—was established protocol set years before Mr. Ortiz arrived at UBS, and with the full understanding and approval of members of UBS PR's Legal and Compliance department. There is no imaginable set of facts under which he could be deemed to have had "ultimate authority or control" over any statements about Fund prices that the newspaper elected to publish. *See Flannery*, at 34. In addition, price information sent by UBS PR (but not by Mr. Ortiz) to the newspaper contained an explicit disclaimer stating that the prices listed were "for informational purposes only" and "subject to market conditions," which negates any plausible inference that price information was disseminated to the paper with any fraudulent or deceptive intent.[80]

Whatever price information the newspaper published cannot be credibly characterized as actionably misleading. The price tables were published in the paper only weekly; any reasonable person would have understood that they could not be current and/or actionable. That *El Vocero* did not explicitly state the obvious—that prices were indicative—cannot be a basis for a fraud charge against Mr. Ortiz. In the unlikely event that a customer did not understand that a price displayed once-a-week in one newspaper might not reflect a firm offer to buy or sell, that customer nonetheless would need to contact a financial advisor to initiate a transaction, who would provide them with the current price information. And, in any event, the evidence will

[80] *See* Tab 39 (SEC Ex. 3); *see also* Tab 40 (February 2008 *El Vocero* Transmissions).

show that indicative prices, even if not actionable, represented the Desk's best judgment as to the prices of the Funds at the time they were provided to *El Vocero.*

B. Prices Contained in Customer Account Statements Are Not Actionable Misstatements.

The Division will likewise be unable to establish that Mr. Ortiz committed securities fraud on the basis of prices reflected in customer account statements. Mr. Ortiz had no responsibility for the preparation of customer account statements. His responsibility included merely the Desk's transmission of current bid prices for inclusion in them, and the evidence will show that Legal and Compliance personnel were fully aware that the transmitted prices might be indicative. On these facts, the Division cannot demonstrate that he had "ultimate authority" for their content. In any event, customer account statements included disclaimers qualifying that prices might reflect estimates and disclosing that statement prices were not actionable; these cautionary disclaimers refute any charge that any representations about price therein were materially false or misleading.[81]

C. The Desk's Temporary Revision of Its Inventory Presentation Was Not An Actionable Misstatement.

The Division criticizes the Desk's decision to reformat inventory sheets in September 2008 to reflect an offer to sell a specific threshold amount of inventory shares for each fund at a stated price (as opposed to the total number of shares). No witness will testify that the change—which lasted only a few weeks, and was made during a period when inventories were relatively low—was intended to deceive FAs. Moreover, the inventory sheets showing this change were circulated daily to UBS PR's compliance department, which raised no objections. The Division's hypothesis—that this brief format change was designed to conceal Fund liquidity

[81] *See* Tab 41 (Sample Customer Account Statements dated November 2008 and October 2009) (disclosing that "[p]rices may or may not represent current or future market value").

conditions from Financial Advisors while UBS PR was planning to issue new Funds in the primary market (OIP ¶ 48)—is speculation based on a reflexive presumption of guilt, rather than a reasoned analysis of the evidence.

D. Mr. Ortiz's Presentation at the March 31, 2009 Investor Conference Was True and Accurate In All Respects.

Mr. Ortiz made a short presentation regarding secondary market Fund trading as part of UBS PR's annual investor conference in March 2009. Evidence will show that his presentation materials—which amounted to 7 out of 109 slides presented at the conference—were fully vetted by appropriate personnel from Legal and Compliance, as well as senior management at UBS PR.[82] And it will show that both Mr. Ortiz's brief statements at the conference, and the materials upon which they were based, were purely factual, historical in nature, and objectively true.[83]

Further, they were accompanied by prominent and cautionary disclosures concerning Fund liquidity and pricing. The slide immediately preceding Mr. Ortiz's remarks cautioned investors that "[w]hile UBS Financial Services Incorporated of Puerto Rico currently intends to maintain a market in the Fund shares, it is under no obligation to do so. Therefore, there may be occasions when you will be unable to sell [y]our shares or will be able to sell at a loss or at times at a significant loss."[84] That same slide additionally told investors that the "market price of the fund shares is based on relative demand and supply of the shares as well as other factors including the general market and economic conditions discussed in the Prospectus" and that, "[a]ccordingly, the value of your investment in the funds will fluctuate and the price that you are

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[82] *See* Tab 42 (SEC Ex. 87) (March 17, 2009 email from C. Ubinas, UBS PR President: "these presentations have always had prior legal review and approval in accordance with internal policy"). In fact, before the conference, each presenter, including Mr. Ortiz, participated in a "dry run" rehearsal before senior executives from various Firm departments to allow opportunity to provide comment or suggestions. No one raised any concerns regarding the content of Mr. Ortiz's presentation.

[83] Tab 43 at slides 57-64 (SEC Ex. 23).

[84] *Id.* at slide 56.

able to obtain for your fund shares may be less than the price you paid in purchasing fund shares."[85] Mr. Ortiz augmented these written disclosures in his concluding remarks, orally conveying to conference participants that investors could experience execution delays due to imbalances in the market.

The Division nonetheless posits that Mr. Ortiz's short statements at the March 31 Investor Conference were somehow rendered misleading by his failure to disclose that, two weeks prior, Mr. Michel had denied his request for an inventory increase and reinstated the Desk's long-standing $30 million limit. *See* OIP ¶ 77. The Division's theory fails as a matter of law and fact. There is no duty in law to disclose risk-based, inventory management decisions. And none of the experienced executives, lawyers and compliance personnel who reviewed and approved Mr. Ortiz's presentation beforehand ever suggested to him that there might be. Nor was Mr. Michel's decision so consequential as a matter of fact that its disclosure might have been required. Mr. Michel's instruction merely resumed the limits the Desk had operated under for the better part of a half-decade, an end that Mr. Ortiz perceived as readily achievable with minimal market disruption. Indeed, between the time of Mr. Michel's decision (March 19) and Mr. Ortiz's presentation at the investor conference (March 31)—a period coincident with the reaffirmation of Puerto Rico's credit rating and other significant, positive market developments[86]—inventory declined by approximately 20%.[87]

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85 *Id.*

86 *Id.* at slides 23 and 24.

87 Tab 44 (UBS PR Funds Aggregate Inventory (3/18/09 – 3/31/09).

IV. MR. ORTIZ ACTED APPROPRIATELY IN RAISING CONCERNS ABOUT THE RISK COMMITTEE'S INVENTORY DIRECTIVE AND THEN IMPLEMENTING THOSE DIRECTIVES ONCE HIS CONCERNS WERE REVIEWED BY APPROPRIATE EXPERTS

The Division's assertions of misconduct in connection with UBS PR's 2009 Fund inventory reduction center on a decision made without Mr. Ortiz's input and affirmed over his objections. UBSFS' Risk Committee—in furtherance of the legitimate aim of reducing risk exposures in response to the ongoing effects of the worldwide financial crisis—imposed an historically low inventory limit ($12 million) and mandated the Desk's prompt compliance. The Division's attempt to find fault with the execution and disclosure of this mandate lack any plausible legal basis. And its attempt to ascribe blame for any alleged failures to Mr. Ortiz's feet is neither plausible nor fair.

A. Mr. Ortiz Did Not Accomplish Any Inventory Reduction Directive Through Manipulation or by "Dumping" Shares

The Division does not dispute that that the inventory reduction mandate was made by the senior executives at UBS PR's parent.[88] Nor does the Division's Order question the propriety of UBSFS' decision to reduce fund inventory as part of its firm-wide risk mitigation strategy.[89] Instead, the Division chooses to take issue with the manner in which the Firm directive was executed. It faults Mr. Ortiz and UBS PR's Trading Desk for accomplishing the Risk Committee's objective too quickly and at prices too low, claiming Mr. Ortiz fraudulently schemed to implement the inventory reduction instructions by "dumping" Fund shares at prices beneath pending customer limit orders. The Division's allegations falter for three reasons.

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[88] *See* OIP ¶ 6 ("The parent's senior executives ordered UBS PR to quickly and substantially reduce its inventory of CEF shares"); ¶ 57 (acknowledging that the establishment of the lower, $12 million limit was mandated by UBSFS' Risk Control Committee).

[89] That the decision to reduce firm-wide risk exposure constitutes a legitimate purpose seems beyond dispute.

First, the Risk Committee, not Mr. Ortiz, set the pace for the inventory reduction. The documentary record establishes—and trial testimony will corroborate—that Mr. Ortiz repeatedly urged a more gradual and orderly reduction program than the Risk Committee initially required. *See supra* p. 15-16. Mr. Ortiz openly questioned the wisdom (though not the propriety) of Risk's decision to cut inventory over such an abbreviated window. Notwithstanding that the inventory reduction order came from the senior-most levels of UBSFS, Mr. Ortiz was not shy about voicing his concerns. He told his bosses, and his bosses' bosses, and their bosses, in no uncertain terms, that he believed that the Risk Committee's decision posed significant risks to Fund investors and the Firm itself. On May 29, 2009, almost immediately upon learning of the directive, he protested to Mr. Michel (UBSFS's Chief Risk Officer) and Mr. Price (UBSFS' U.S. Head of Wealth Management):

> I see great risk for the Firm and potential destruction of investors' wealth in our market if we go ahead with this decision. Additionally, I am not sure it was reached with the correct analysis, which I did not have a chance to comment on before its presentation at the RCC [Risk Control Committee].[90]

He urged alternative courses of action that he believed would better protect clients and the Firm, and better equip the Desk to appropriately supply liquidity to the market.[91] And even when the Risk Committee refused to adopt those recommendations, he persisted in lobbying to pace inventory reductions more slowly so as to minimize market disruption and client impact.[92]

Mr. Ortiz's efforts to moderate the May 2009 inventory reduction mandate, and to obtain additional flexibility in its implementation, were directed to the goal of maintaining an orderly

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[90] *See* Tab 22.

[91] *See* Tab 25 (SEC Ex. 88); Tab 26 (June 17, 2009 email from C. Ortiz to B. Michel); Tab 27 (UBSPR-SEC-021-015434-35) (June 19, 2009 email from C. Ortiz to B. Michel listing concerns about the mandate and providing his "recommendation as to a course of action that is realistic and protects the interests of our clients and the Firm").

[92] For instance, in June 2009 when Risk implemented a hard-and-fast requirement that UBS PR reduce fund inventory by $1 million per week to bring its position within the new, $12 million limit, Mr. Ortiz successfully persuaded Risk to amend that Rule to allow the Desk flexibility to accommodate client intra-month liquidity demands. *See* Tab 25 (SEC Ex. 88) at UBSPR-SEC-023-00173.

market during the transition to a lower inventory level. In fact, while there were price reductions following the mandate, they did not reflect a collapse in the market. Between June 1, 2009 and September 30, 2009, 15 of the 23 Funds had overall price reductions of less than 5%, and none had a reduction of more than 10%.[93] These good faith efforts to protect investors while meeting valid Firm risk concerns cannot be squared with the Division's allegations that Mr. Ortiz "orchestrated" a scheme to implement the Risk Control Committee's mandate through aggressive "dumping" of Fund shares.

Second, the Division's attempt to fault Mr. Ortiz for selling inventory shares at prices below pending customer orders is untenable as a matter of fact and law. Mr. Ortiz was required to implement the Risk Committee's inventory directives by selling inventory. Both regulatory prohibitions and UBS PR's Trading Guidelines prevented the Desk from selling shares for its own account at prices that would satisfy an accepted and held client order.[94] In order to lower its own inventory position (as now required by the Risk Committee), while complying with order priority rules (as required by the securities laws), the Desk had no choice but to dispose of its shares at prices lower than what customers looking to sell had indicated a willingness to accept for their own shares. As with all price changes, FAs and UBS PR's Pricing Department received immediate notification of any and all reductions in this period, and customers were free to match the Desk's offers if they wished to be executed ahead of the Desk.

Third, the Desk's execution of the inventory directive was closely monitored by the Risk Committee. Mr. Ortiz regularly kept senior Legal and Compliance personnel in the loop regarding the Desk's plans and progress in executing the Risk Committee's mandates. For instance, Mr. Ortiz explicitly disclosed to his superiors, to in-house counsel, and to compliance

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[93] Tab 46 (UBS PR Fund Bid Differences (6/1/09 – 9/30/09). Fund prices have since rebounded, and today generally trade at prices equal to or greater than their prices before the May 2009 inventory reduction mandate.

[94] *See supra* n. 28.

personnel that in order to "reduce funds inventory, we are . . . [l]owering our price to keep ahead of any client open orders."[95] Senior risk, legal and compliance personnel—the same executives who ordered the inventory reduction in the first place—were thus fully apprised of the obvious: that to sell inventory shares, UBS PR might need to lower the price it was willing to accept below that of clients looking to sell.

B. Mr. Ortiz Did Not Conceal Inventory Management Directives

The evidence will also refute the Division's claim that Mr. Ortiz concealed the Firm's inventory reduction mandates from FAs. To the contrary, Mr. Ortiz and others on the Trading Desk openly discussed both the inventory reduction mandate and the fact that the Desk was buying only limited quantities of Fund shares with FAs in the course of their regular and informal interactions with them.[96] To the extent that some FAs may not have been directly informed of the directive by the their branch or sales managers or other senior managers within the Firm that were aware of the decision, many of those FAs would nonetheless have plainly been aware that UBS PR was reducing inventory through the Spring and Summer of 2009. FAs had a wealth of information at their disposal—largely as a result of Mr. Ortiz's efforts to enhance transparency—that would have made it apparent that the Firm was reducing inventory levels at this time, including: (i) daily publication of the "Good-til-Cancelled" book, which disclosed all open marketable customer orders; (ii) daily circulation of inventory sheets showing the amount of shares for bid and offer, current bid/offer prices, and an explanation of which bids are firm and which are indicative; and (iii) their own knowledge of order flow, based on their customer

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95 *See* Tab 25 (SEC Ex. 88).

96 *See* Tab 26 (UBSPR-SEC-045-018812) ("clients and FAs are very concerned with this mandate"); Tab 27 (UBSPR-SEC-021-015434-35) ("I had a conversation yesterday with two Chairman's Club level FA's whose clients hold a significant amount of shares in the funds. They expressed great frustration and concern with the fact that the firm is not a buyer of funds at this time. Their perception is that UBS is abandoning the market. They say that they cannot responsibility recommend to their clients the purchase of a security that the Firm is no longer willing to support. They cannot understand how the Firm expects to manage a market with a capitalization of approximately $5 billion with severely reduced position limits").

interactions and delays in execution. Indeed, the record will reflect that FAs did, in fact, learn either directly or indirectly that the Desk was reducing its Fund inventory during the relevant period.

Moreover, Mr. Ortiz expressly discussed the directive with Mr. Belaval (Regional Director of Wealth Management) and Mr. Garcia (Deputy Regional Director of Wealth Management), who (unlike Mr. Ortiz) had direct supervisory responsibility over financial advisors and thus were obviously best positioned to disseminate necessary information to FAs.[97] Mr. Ortiz also understood that the fund inventory reduction mandate originated with, and was being monitored by, the Firm's Risk Control Committee, whose expert membership would have been best equipped to identify and effect any disclosure obligation arising from it (if, as the Division contends, there even was one).[98] No member of Market Risk, Legal, Compliance or Senior Management ever instructed Mr. Ortiz or anyone else that such disclosure might be required.

Since he was not responsible for the risk reduction directive, and because he did not supervise FAs, Mr. Ortiz would have had no reason to believe that it was his responsibility to convey to FAs that the Firm had made a decision to reduce the inventory limits of the Funds. Even so, Mr. Ortiz flagged the potential disclosure issue and expressly raised the question of whether a broader dissemination of the mandate might be required. In an email to senior UBSFS and UBS PR management shortly after the directive to reduce fund inventory levels to $12 million, Mr. Ortiz wrote: "I believe we should consult Legal-Compliance on the need to clearly

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[97] *See, e.g.*, Tab 25 (SEC Ex. 88); Tab 24 (SEC Ex. 78); Tab 27 (UBSPR-SEC-021-015434); Tab 45 (SEC Ex. 21).

[98] *See* Tab 47 (SEC Ex. 111) ("The Mutual Fund Trading desk in cooperation with Risk Control will work on an implementation plan to reduce the size of the portfolio"); Tab 24 (SEC Ex. 88) (June 9, 2009 email from B. Michel to C. Ortiz, cc'ing J. Price, M. Ferrer, C. Ubinas, E. Belaval, T. Naratil, which is ultimately forwarded to Legal, discussing specifics of the inventory reduction mandate).

inform the market of our change in practice regarding funds trading."[99] The Risk Committee did just that. As reflected in the Risk Committee's Second Quarter Risk Report, in connection with the inventory reduction mandate:

> Legal & Compliance . . . completed an analysis of relevant disclosure documents and educational materials for FAs. It was concluded that disclosures adequately reflect risks for investors and explain UBS's obligations as a liquidity provider. The educational material sufficiently explains the product and its risk to FAs[100]

Thus, Mr. Ortiz responsibly elevated the potential disclosure issue to counsel and senior management, who duly considered whether additional disclosure of the Firm's inventory management decision was advisable or required, and concluded it was not. Any fault the Division would find with this decision cannot lie with Mr. Ortiz. Indeed, his escalation of the matter to counsel evidences the very prudence, responsibility, and good faith that characterizes Mr. Ortiz's conduct throughout the challenged period. Such conduct cannot be squared with the Division's theories of deliberate or negligent misconduct.

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[99] Tab 26 (UBSPR-SEC-045-018812).

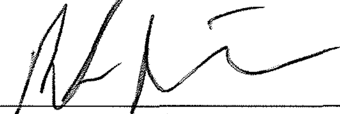
[100] Tab 28 at UBSPR-SEC-020-000033.

CONCLUSION

We respectfully submit that the Hearing will establish that the Division's allegations and charges are without factual and legal merit.

Dated: September 14, 2012

Respectfully,



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